Supreme Court, U.S.
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No.

In the

Supreme Court of the United States

EDWARD J. DEEGAN
and JOAN S. DEEGAN,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON A PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Sallie W. Gladney,
Counsel of Record
Thomas E. Redding,
Teresa J. Womack,
Redding & Associates, P.C.
2914 West T.C. Jester
Houston, TX 77018
(713) 965-9244
Attorneys for Petitioners

QUESTION PRESENTED

1. Partnership-level suits may be brought in Article I or Article III courts. For tax year 1985, 26 U.S.C. §6226(d)(1)(B) and (f) specifically bar partners with expired assessment deadlines from participating and bar subject matter jurisdiction over non-partnership items. Can courts by their mere "practice" create the standing, personal jurisdiction, and subject matter jurisdiction Congress expressly denied, such that for tax year 1985 partners with expired assessment periods can raise their limitations deadline only in partnership-level suits?

2. Items with both partnership item elements and non-partnership item elements are affected items. Section 7422(h) bars jurisdiction over claims for refunds "attributable to" partnership items. May courts disregard Congress's definitions and 25 years of precedent to reclassify affected items as partnership items for the sole purpose of imposing §7422(h)'s jurisdictional bar?

3. Section 7422(h) bars jurisdiction only refunds "attributable to" partnership items. Penalty interest imposed under former §6621(c) is an affected item, not a partnership item. Does §7422(h) bar jurisdiction over

refunds attributable to the IRS's failure to apply Treas. Reg. §301.6621-2T, A-5 to determine what portion of the assessment is subject to the penalty interest rate?

PARTIES TO THE PROCEEDINGS BELOW

The following are parties to the proceeding in the matter before the Court of Appeals for the Federal Circuit:

Edward J. Deegan

Joan S. Deegan

The United States of America

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OPINIONS BELOW

Judgment without opinion was summarily issued by the Court of Federal Claims ("CFC") in *Deegan v. U.S.*, 06-594 following the entry of judgment and decision in *Prati v. U.S.*, 81 Fed.Cl. 422 (2008). App:38-84, 187.[1] The opinion denying reconsideration in *Prati* is published at 82 Fed.Cl. 373 (2008). App:21-37. Appeals for both cases were filed in the Federal Circuit. *Deegan v. U.S.*, Fed.Cir. No. 08-5129 was combined with *Prati v. U.S.*, Fed.Cir. No. 08-5117 for appellate briefing. The opinion of the Federal Circuit is reported *sub nom* at *Prati v. U.S.*, 603 F.3d 1301 (Fed.Cir. 2010). App.1-20. A contemporaneous petition for *certiorari* has been filed for *Prati*.

JURISDICTION

Judgment was entered on May 5, 2010. Rehearing *en banc* was denied on August 3, 2010. This Court has jurisdiction under 28 U.S.C. §1254(1).

[1] References to "App:x" are to page "x" of the attached Appendix.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS

The relevant constitutional provisions, statutes, and regulations are set forth in the appendix, including, of particular focus, Article I, Section 8, Clauses 1 and 9 and Article III, Sections 1 and 2 of the Constitution of the United States, §§6226, 6229, 6501, 6621(c), and 7422(h).[2] App:154, 155, 165-67, 172, 156, and 175.

STATEMENT OF THE CASE

1. Statement of Related Cases

Petition for a writ of *certiorari* has been requested for *Prati v. U.S.*, (Fed.Cir. #08-5117). Unlike the Pratis, the Deegans did not settle their partnership items with IRS using Forms 870-P(AD).

Over 50 indirectly related appeals addressing these jurisdictional issues are stayed before the Federal Circuit. App:188.

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[2] Unless otherwise stated, all references to "section" and § are to the Internal Revenue Code at 26 U.S.C. effective for tax year 1985.

2. Background Facts

In 1985, Edward J. Deegan invested as a limited partner in USB-1985 Associates ("USB-1985"), an "AMCOR" agriculture-related limited partnership subject to TEFRA.[3] The partnership and the Deegans filed their 1985 federal tax returns in 1986. The Deegans reported their allocated partnership items and paid their tax owed. The IRS had three years to assess any additional tax attributable to the Deegans' partnership items, unless a valid exception applied.[4] The IRS never requested an extension of their assessment deadline.

In 1991, after the Deegans' assessment deadline expired, the IRS issued a notice of final partnership administrative adjustment ("FPAA") for USB-1985 that proposed to entirely disallow farming expenses and "other deductions" on over a dozen separate, alternative, independent, and sometimes

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[3] 26 U.S.C. §§6221-6233, as enacted by the Tax Equity and Fiscal Responsibility Act of 1982, Pub.L. No. 97-248, 96 Stat. 324; see *Maxwell v. C.I.R.*, 87 T.C. 783, 787 (1986). USB-1985 is one of roughly 43 related limited partnerships generically known as the AMCOR partnerships.

[4] §6501(a). App:172.

mutually-exclusive grounds. Some grounds were alleged tax motivated transactions ("TMTs") for purposes of imposing the §6621(c) penalty interest[5] rate though most were not.[6] A partner other than the tax matters partner ("TMP") filed a partnership-level suit in the Tax Court contesting the FPAA.[7]

By statute the Deegans could not participate in the partnership-level suit because their assessment deadline had expired

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[5] Though not technically a penalty, §6621(c) is commonly referred to as "penalty interest." *Matter of Hardee*, 137 F.3d 337, 342 (5th Cir. 1998).

[6] In 1986, Congress enacted §6621(d), later re-codified at §6621(c), allowing the IRS to impose interest at 120% of the normal rate if the tax is solely attributable to one of the TMTs identified by statute or regulation. It was enacted to "encourage" settlements in order to clear the Tax Court's docket. *Todd v. C.I.R.*, 862 F.2d 540, 544 n. 14 (5th Cir. 1988). In 1989, Congress repealed §6621(c) but not retroactively for prior tax years. *McGann v. U.S.*, 81 Fed. Cl. 642, 647 (2008).

[7] Normally, partnership-level suits are filed by the TMP, who then controls the litigation. §6226(a). App:160.

in 1989.[8]

Unlike the Pratis, the Deegans did not enter into individual settlement agreements with the IRS. Instead, as the Federal Circuit found, in 2001, the IRS moved for an agreed decision under Tax Court Rule 248(b), representing that the IRS and the TMPs had reached agreement respecting all disputed partnership items and all partners who met the §6226(d) interest requirements were deemed parties bound by the decisions. The Tax Court entered stipulated decisions on July 19, 2001, and the IRS then assessed taxes at the §6621(c) interest rate against those partners who had not settled with the IRS (including the Deegans). The Deegans paid the assessments in full and filed refund claims in 2004, which were denied. The Deegans filed suit in the CFC in 2006.

3. Proceedings Below

Deegan was jointly stayed in the CFC after filing. The government never filed an answer. No record was developed. No documentary or testimonial evidence was ever presented.

In April 2008, the CFC granted the

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[8] §6226(d)(1)(B). App:160.

government's motion and dismissed the Pratis' limitations claim holding:

(i) §7422(h) barred jurisdiction because their claim challenged only §6229(a), a partnership item, App:64 and 70;

(ii) even if their assessment deadline is an affected item, §7422(h) bars jurisdiction because it has a possible partnership item *element*, App:64, and;

(iii) the Pratis waived their limitations claim because "they could have pursued their limitations defense in the earlier partnership-level proceeding." App:73.

The CFC also dismissed the Pratis' §6621(c) claim, holding it inherently disputed the characterization of a partnership item and was, thus, barred by §7422(h). App:82.

Following *Prati*, Judge Block summarily entered judgments in *Deegan* and the other 76 related cases then pending in the CFC. The Deegan judgment stated "all claims by the plaintiffs are dismissed for lack of jurisdiction." App:187.

The Deegans appealed pursuant to 28 U.S.C. §1295(a)(3).

On May 5, 2010, the Federal Circuit

affirmed both *Prati* and *Deegan*, but on different grounds than the CFC. App:1-20.

As to limitations, the Federal Circuit held that

(i) §7422(h) bars refund jurisdiction because §6501 and 6229 "operate in tandem to provide a single limitations period" that is itself a partnership item, not an affected item, and

(ii) the Pratis were "required to raise the limitations issue in the partnership-level proceeding prior to either entering settlement or stipulating to judgment in the Tax Court."

App:16-17. Without addressing either the plain language of pre-1997 §6226 (which bars access, both jurisdiction and standing) or the prospective effective date of their 1997 amendments, the Federal Circuit held that those amendments "merely codified prior practice of the Tax Court" and the Pratis and Deegans were, therefore, "free to participate in the partnership-level proceedings to litigate the statute of limitations issue." App:17.

As to penalty interest, the Federal Circuit never analyzed whether penalty interest is properly classified as a partnership item or an

affected item. Rather, it held that to *apply* a previously determined partnership item in a partner-level refund suit is *per se* to challenge that prior determination and requires that the partnership item be re-determined, which §7422(h) denies jurisdiction to do. App:19.

REASONS TO GRANT THE PETITION

For 25 years any item with partnership item elements and non-partnership item elements was classified as an affected item and all affected items were resolved at the partner level under TEFRA's established procedures, including partner-level refund suits. Under that framework both limitations on assessment and penalty interest are properly classified as affected items. As such, §7422(h) could not bar jurisdiction over such claims in partner-level refund suits.

Without regard to its own binding precedent regarding TEFRA's affected item classification and procedures and the limited scope of §7422(h)'s jurisdictional bar, the Federal Circuit now holds §7422(h) to be so broad as to bar all affected item refund claims in partner-level suits.

The Federal Circuit's use of a hammer to

get a square peg through a round hole succeeds only in damaging both. The most egregious consequences are

- a direct assault on the doctrines of separation of powers and standing,
- conflicts with multiple circuits
  - inter- and intra- circuit conflicts over the proper procedures to classify and resolve affected items; specifically, conflicts with the D.C. Circuit (*Petaluma*) and the Federal Circuit *(Jade Trading)*,
  - direct conflict with the Second Circuit (*Field*) as to the proper jurisdictional forum for refunds attributable to §6621(c) penalty interest, and
- the overbroad interpretation of §7422(h) to bar jurisdiction in partner-level suits over *all* claims for refunds attributable to affected items.

If unreviewed, the Federal Circuit's bar to jurisdiction over *all* affected item refund claims directly impacts millions of partners in thousands of partnerships subject to TEFRA. These jurisdictional issues continue to plague the trial and appellate courts resulting in conflicting opinions and rationales which

urgently require guidance from this Court.

1. **Congress's Procedural Framework for TEFRA**

TEFRA can be explained simply or accurately, but not both.

Partnerships file information returns allocating their income, deductions, *etc.*, among the partners, who are required to then report those items consistently on their personal returns. Before 1982, adjusting a partnership's tax treatment required repeated reconsideration via every partner's return. In 1982, Congress enacted TEFRA, giving the IRS some, *albeit* limited, administrative relief.

Critically, TEFRA creates three categories of items: partnership items, non-partnership items, and affected items. Generally, a partnership item is any item in subtitle A, properly designated by regulation, that "affects the partnership as a whole."[9] A non-partnership item is any "item which is (or is treated as) not a partnership item."[10] Affected items are a special subset of non-partnership items defined as "any item to the extent such

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[9] §6231(a)(3). App:170.

[10] §6231(a)(4). App:170.

item is affected by a partnership item."[11] Affected items are the "hybrids", *i.e.*, items with both partnership item elements and non-partnership item elements.[12] By definition, affected items are *not* partnership items.[13]

Before the IRS can assess partnership-related tax against a partner it must first adjust any items (partnership, non-partnership, or affected) on which the assessment is based. Partnership items must be adjusted first[14] — either at the partnership level (*e.g.*, in a partnership-level suit) or the partner level (*e.g.*, as here, in a partner's individual settlement).[15]

If the IRS cannot get agreements binding on all the partners, then it can try to adjust the

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[11] §6231(a)(5). App:170.

[12] *McGann*, 81 Fed.Cl. at 643; *Duffie v. U.S.*, 600 F.3d 362, 366 (5th Cir. 2010).

[13] *Dial USA, Inc. v. C.I.R.*, 95 T.C. 1, 5 (1990); *Affiliated Eqmt*, 97 T.C. at 578.

[14] *N.C.F. Energy Partners v. C.I.R.*, 89 T.C. 741, 744-45 (1987).

[15] §§6224(c)(1), 6226(a) and (b), 6231(c)(2). App:158, 160-61, and 172.

partnership items unilaterally by issuing an FPAA proposing adjustments for a specific tax year (the "FPAA year").[16] The resulting tax is not limited to the FPAA year[17] and whether a partner is bound to the FPAA adjustments is determined by that partner's individual facts.[18]

There is no deadline to issue an FPAA.[19] An FPAA issued after 30 years is valid to adjust partnership items as long as it is the first issued to that partner for that partnership tax year.[20]

FPAAs can normally be challenged only in §6226 partnership-level suits, which can be

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[16] §§6223(a) and (d)(2), 6231(a)(8). Add:171.

[17] *E.g.*, carryover years, etc. See *Kligfeld Holding v. C.I.R.*, 128 T.C. 192, 205 (2007); *Curr-Spec Partners, L.P. v. C.I.R.*, 579 F.3d 391, 399-400 (5th Cir. 2009).

[18] *E.g.*, whether, when, and on what terms his partnership items are converted to non-partnership items.

[19] *Curr-Spec*, 579 F.3d at 399.

[20] §6223(f). App:157.

brought either in the Article I Tax Court[21] or CFC,[22] or in the Article III federal district courts.[23] The relevant AMCOR partnership-level suits were filed in the Tax Court. App:6.

Generally, partners are parties to and may participate in partnership-level suits.[24] However, for pre-1997 tax years Congress *specifically forbids* a partner to participate after *his* assessment deadline expires, *i.e.*, Congress expressly denies Article I and Article III courts personal jurisdiction over those partners and denies such partners standing in Article III courts.[25] Tax Court rules expressly reiterate this bar.[26] The plain language of §6226(d)(1)(B) makes clear that the

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[21] §7441. App:175.

[22] 28 U.S.C. §171(a). App:179. See *Freytag v. C.I.R.*, 501 U.S. 868, 889 (1991) (Tax Court and CFC are Article I courts).

[23] §6226(a) and (b); 28 U.S.C. §§1346(e) (district court) and 1508 (CFC) App:160-61, 179-81.

[24] §6226(c); Tax Court Rule 247. App:162, 185.

[25] §6226(d)(1)(B). App:162.

[26] Tax Court Rules 245(b), 247(a) and (b). App:185.

assessment deadline is partner-specific.[27] App:162.

For pre-1997 tax years, §6226(f) grants courts in partnership-level suits subject matter jurisdiction *only* to determine and allocate partnership items.[28]

In 1997, Congress amended §6226(d) to allow partners with expired assessment deadlines to raise their partner-specific limitations defense in partnership-level suits. App:177-78. It also amended §6226(f) to marginally expand subject matter jurisdiction to "the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item".[29] App:178. The §6226(f) amendment did *not* expand jurisdiction to non-partnership items generally. Congress expressly made the §6226 amendments effective only for tax years ending

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[27] *Curr-Spec*, 579 F.3d at 399-400.

[28] §6226(a) and (f). App:160-61, 163. *Crop Assoc.-1986 v. C.I.R.*, 113 T.C. 198, 201 (1999).

[29] Taxpayer Relief Act of 1997, P.L.105-34 §§1238(b) and 1239(b).

after August 7, 1997.[30]

The IRS and the bound partners are required in any partnership item proceeding to obtain and preserve the determination of any partnership item they later rely on. However, no party is permitted to raise any *non*-partnership item (including affected items and any non-partnership item *element* of an affected item).[31]

Once a binding partnership item proceeding is concluded (by defaulted FPAA, settlement, partnership-level suit, etc.), then the IRS can assess tax attributable to any resulting partnership item adjustments but *only* if that partner's §6501(a) assessment period is still

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[30] Compare Taxpayer Relief Act of 1997, P.L.105-34 §§1236(a), 1237(a), (b), and (c)(1), amending §§6227 and 6230 "as if included in the amendments made by §403 of P.L. 97-248," *i.e.*, generally effective as if originally enacted with TEFRA in 1982.

[31] *Maxwell*, 87 T.C. at 788; *N.C.F. Energy*, 89 T.C. at 745-47; *Dial USA*, 95 T.C. at 6; *Affiliated Eqmt.*, 97 T.C. at 579; *Petaluma FX Partners, LLC v. C.I.R.*, 591 F.3d 649 (D.C.Cir. 2010) at App:123-26; *Jade Trading, LLC v. U.S.*, 598 F.3d 1372 (Fed.Cir. 2010) at App:104-08.

open – three years from the date the *partner* files his return, plus any binding exceptions.[32] The IRS can also assess any tax attributable to affected items,[33] but only after making any required partner-level determinations[34] and applying the applicable regulations.

Section 6229(a) extends the §6501(a) assessment deadline of all bound partners until three years after the *partnership* files its return. App:165. If an FPAA is issued while a partner's assessment period is open for any reason, that period is suspended until after any relevant binding partnership item proceeding is completed.[35] An FPAA issued after a partner's assessment period expires cannot re-open that period.[36]

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[32] *A.D. Global Fund v. U.S.*, 481 F.3d 1351, 1354 (Fed.Cir. 2007); *Curr-Spec*, 579 F.3d at 399.

[33] Subject to the normal deficiency proceedings of subchapter B (§§6211-6216) and §6501.

[34] §6230(a)(2). App:168.

[35] §§6225(a)(2), 6229(d) and (f), 6231(b)(1). App:160, 166, and 171.

[36] *Curr-Spec*, 579 F.3d at 398-99; Any partner may waive the restrictions on assessment as to himself

After an assessment is paid, a partner may claim a refund asserting his partner-level non-partnership item and affected item defenses.[37] If the IRS fails or refuses to pay, he can generally file suit in federal district court or the CFC.[38]

In a partner-level affected item refund suit, the court has jurisdiction to determine any non-partnership items, including affected items.[39] To determine an affected item, the court *applies* any previously determined partnership item elements binding on that partner – which are *res judicata* – to its new determinations of the non-partnership item

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at any time. §6224(b). App:165-66. The TMP cannot waive the assessment deadline of any other partner. The TMP can, however, extend the assessment deadline of some partners whose assessment periods are open when the extension becomes effective. §6229(b)(1). App:165.

[37] *Olson v. U.S.*, 37 Fed.Cl. 727, 733-34 (1997), *aff'd* 172 F.3d 1311 (Fed.Cir. 1999).

[38] §7422(a); 28 U.S.C. §§1346(a)(1) and 1491(a). App:175, 179-81.

[39] *Maxwell*, 87 T.C. at 788.

elements.[40] Section 6221 bars the court from making any *new* partnership item determinations. App:156. If a bound party fails to obtain and preserve in the proper forum the determination of a partnership item element that it bears the burden to prove in a later affected item proceeding, then that party loses as to that element. Where there was no partnership item proceeding (*e.g.*, if no FPAA was issued), then as to that partner, the partnership items are conclusive as filed on the partnership's return.[41]

Because partnership items cannot be determined in partner-level refund suits, §7422(h) bars jurisdiction over any claim for a "refund attributable to partnership items (as defined in §6231(a)(3)) . . . ." App:170. By its plain terms, §7422(h) cannot bar claims attributable to non-partnership items or affected items. Similarly, §7422(h) cannot bar jurisdiction merely because the *assessment* of the amount paid was attributable to

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[40] *Petaluma*, at App:123-24.

[41] *Roberts v. C.I.R.*, 94 T.C. 85, 860-2 and n. 6 (1990).

partnership items.[42] For §7422(h) to bar jurisdiction over the entire claim, it is the *refund*, not the underlying assessment, that must be solely attributable to partnership items.[43]

2. The Federal Circuit's Opinion is a Direct Assault on the Doctrines of Separation of Powers and Standing

Generally, §6226(c) authorizes partners to participate in and be parties to partnership-level suits. App:162. However, for pre-1997 tax years, Congress in §6226(d)(1)(B) requires that

> (d) PARTNER MUST HAVE INTEREST IN OUTCOME.—
>
> (1) IN ORDER TO BE PARTY TO ACTION.—Subsection (c) **shall not** apply to a partner after the day on which—
>
> . . . .
>
> (B) the period within which any tax attributable to such

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[42] *Alexander v. U.S.*, 44 F.3d 328, 332-3 (5th Cir. 1995); *Field v. U.S.*, 328 F.3d 58, 59-60 (2nd Cir. 2003).

[43] *Field*, at 59-60. App:86-90.

> partnership items may be assessed against that partner expired.

App:162, emphasis added.

The Deegans have always asserted their assessment period expired in 1989 (three years after they filed their 1985 personal return) and no exception applies. Consistent with this position they did not participate in the partnership-level suit, where they were barred by §6226(d)(1)(B).

In 1997, Congress amended §6226(d)(1), allowing such partners to participate for the sole purpose of asserting that their assessment period had expired. App:177-78. But Congress expressly made its §6226 amendments effective only for tax years ending after August 5, 1997, the date of the amendment's enactment. This effective date protected partners, like the Deegans, who had already relied on the pre-1997 language.

Without acknowledging the plain language of pre-1997 §6226, the Federal Circuit held that "the 1997 amendment merely codified prior practice in the Tax Court" and the Deegans were, therefore, *required* "to participate in the partnership-level proceedings to litigate the statute of limitations issue." App:17 and n.4.

This holding – that the "practice" of a court controls over an unambiguous statute – is a direct assault on the separation of powers and the appropriate restrictions that doctrine places on access to the courts. It empowers both Article I and Article III courts to create by their "practice" the exact standing and/or jurisdiction (both personal and subject matter) that Congress specifically and unambiguously forbade. This judicial overreach and usurpation of power expressly delegated to Congress, if left unreviewed, is an invitation to undermine the separation of powers so fundamental to our democratic republic. After all, if a court's "practice" can overpower a specifically tailored, unambiguous statute it can certainly overpower a silent or ambiguous one in non-statutory cases (*e.g.*, citizen suits).

a. The Federal Circuit Empowers Courts to Violate the Separation of Powers

The central judgment of the Framers of the Constitution was that, within our tripartite political structure, separation of powers is essential to preserve our liberty and republic.[44]

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[44] *Mistretta v. U.S.*, 109 S. Ct. 647, 658 (1989); *see also Morrison v. Olson*, 487 U.S. 654, 697 (1988) (Scalia, J., dissenting) ("The Framers of the Federal Constitution [ ] viewed the principle of

To ensure proper separation of powers this Court recognizes limits " 'founded in concern about the proper—and properly limited—role of the courts in a democratic society.' "[45] All federal courts are courts of limited jurisdiction.[46] These limits apply "with added force to Article I [courts] . . . which owe their existence to Congress' authority to enact legislation pursuant to Art. I, §8 of the Constitution."[47] App:154.

Congress established TEFRA's complex procedural framework defining the legal

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separation of powers as the absolutely central guarantee of a just Government.").

[45] *Allen v. Wright*, 468 U.S. 737, 750, (*quoting Warth v. Seldin*, 422 U.S. 490, 498 (1975)). *Bowles v. Russell*, 551 U.S. 205, 212-13 ("Within constitutional bounds, Congress decides what cases the federal courts have jurisdiction to consider .... [I]t can also determine when, and under what conditions, federal courts can hear them.").

[46] *Owen Equip. & Erection Co. v. Kroger*, 437 U.S. 365, 374 (1978) ("It is a fundamental precept that federal courts are courts of limited jurisdiction. The limits upon federal jurisdiction ... must be neither disregarded nor evaded.").

[47] *U.S. v. Denedo*, 129 S. Ct. 2213, 2221 (2009).

obligations and duties of the IRS and the partners, the class of persons entitled to enforce those duties, and each court's appropriate jurisdiction to resolve disputes based on the nature of the controversy.

Pre-1997 §6226(d)(1)(B) is not silent or ambiguous. Partners with expired assessment periods "shall not" participate in partnership-level suits for any reason and are, therefore, not within the class of persons entitled to enforce those duties in that forum.

Similarly, the plain language of pre-1997 §6226(f) limits partnership-level jurisdiction to the determination and allocation of partnership items. App:163. The date a partner files his individual return is a non-partnership item and one of the elements of his assessment period.[48]

Congress logically determined that the proper time and forum to address limitations on assessment is after the partnership items are resolved, in either a pre-payment Tax Court suit, if available, or in a refund suit before the CFC or a federal district court – where courts have jurisdiction to determine all non-partnership item elements of that affected

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[48] §6501(a). App:172.

item, including those that cannot occur until after the partnership item proceeding, if any, is completed (*e.g.*, the date of the assessment or application of Treas. Reg. §301.6621-2T, A-5 for purposes of penalty interest). Congress specifically made its §6226 amendments effective only for tax years ending after the date of the amendments' enactment thereby avoiding an unfair change in the law for partners who had relied on the prior language as to partnership-level suits then-pending.

The principle of separation of powers calls for judicial self-restraint not to second-guess Congress's policy decisions, unless a constitutional concern is implicated.[49]

The Federal Circuit violated that fundamental rule, holding that Tax Court "practice" is sufficient to create personal jurisdiction over partners and subject matter jurisdiction over non-partnership item elements of their assessment deadlines, despite Congress's express statutory denial of exactly that jurisdiction.[50] This authorization

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[49] *American Fire & Casualty Co. v. Finn*, 341 U.S. 6, 17 (1951).

[50] *Steel Co. v. Citizens for a Better Environment*, 523 U.S. 83, 101 (1998) ("... [E]lements of

of courts to enlarge their powers at the expense of Congress's ability to control the jurisdiction of federal courts eviscerates the principle of separation of powers and undermines respect for the roles of the coordinate branches.[51]

b. The Federal Circuit's Opinion Undermines the Doctrine of Standing

Partnership-level suits may be brought in either Article I courts (the Tax Court or CFC) or Article III courts (federal district courts).[52] Therefore, even though the AMCOR partnership-level suits were before the Tax

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jurisdiction are an essential ingredient of separation and equilibration of powers, restraining the courts from acting at certain times, and even restraining them from acting permanently regarding certain subjects.").

[51] *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 164 (2008), *citing Wilder v. Virginia Hospital Assn.*, 496 U.S. 498, 509, n. 9, 110 S.Ct. 2510, 110 L.Ed.2d 455 (1990) (requirement of congressional intent "reflects a concern, grounded in separation of powers, that Congress rather than the courts controls the availability of remedies for violations of statutes").

[52] §6226(a) and (b). App:160-61.

Court, the Federal Circuit's opinion below also impacts the jurisdiction of the CFC and the federal district courts in partnership-level cases.

The following hypothetical is used only to avoid the confusion of repeated double negatives. If

(i) the AMCOR partnership-level suits had been filed in federal district court, and

(ii) the Deegans had tried to raise the non-partnership item elements of their assessment deadline, and

(iii) the government had opposed them, asserting they lacked standing,

then who would have won – the government because, as discussed regarding the separation of powers, §6226(d)(1)(B) barred the Deegans from the class of persons entitled to enforce their assessment deadline at the partnership level. And because §6226(f) barred that forum (§6226 partnership-level suits) from determining *any* non-partnership item, including non-partnership item elements of affected items.

Standing cases are generally divided into statutory and non-statutory (*e.g.*, constitutional) cases. "Essentially, the

standing question ... is whether the constitutional or statutory provision on which the claim rests properly can be understood as granting persons in the plaintiff's position a right to judicial relief."[53] This is a statutory standing case because §6226(d)(1)(B) speaks directly and unambiguously to the issue: partners whose assessment periods have expired are not within the class of persons entitled to participate in §6226 partnership-level suits.

The unambiguous statute should end the matter. Only if the statute is silent or unclear should a court proceed to the next level of a standing analysis. But the Federal Circuit effectively deems pre-1997 §6226(d)(1)(B) to be superceded by purported Tax Court "practices." Had pre-1997 §6226(d)(1)(B) never existed,

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[53] *Warth v. Seldin*, 422 U.S. 490, 500-501 (1975); see also *Clarke v. Sec. Ind. Assoc.*, 479 U.S. 388, 400 (1987) (standing to sue "turns on congressional intent, ..."); see also *Barlow v. Collins*, 397 U.S. 159, 167 (1970); *Bread Political Action Comm. v. F.E.C.*, 455 U.S. 577, 581 (1982), *quoting Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980); Scalia, Antonin: *The Doctrine of Standing as an Essential Element of the Separation of Powers*, 17 Suffolk U. L. Rev. 881,885 (1983).

then the court should have proceeded to apply the constitutionally-based factors for "prudential" standing, including whether the partner's non-partnership item elements are within the "zone of interest" protected by the law invoked.[54] Again, standing would be denied; this time because §6226(f) excludes all non-partnership items, including the non-partnership item elements of affected items from the courts jurisdiction.

If the Deegans had tried in to assert limitations in the USB-1985 partnership-level proceeding and the government had opposed them, they could not have participated. But the government will certainly respond that the IRS did not oppose other AMCOR partners who purportedly participated to raise their "limitations issue" in the partnership-level Tax Court cases. The government's consent is irrelevant. Standing is jurisdictional and not subject to waiver.[55]

The Federal Circuit's opinion authorizes courts in statutory standing cases to disregard

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[54] *Allen*, 468 U.S. at 751; *Ass'n of Data Processing Serv. Org., Inc. v. Camp*, 397 U.S. 150, 155-56 (1970).

[55] *Lewis v. Casey*, 518 U.S. 343, 349 n. 1 (1996).

those statutes. And if courts are now empowered to create standing, personal jurisdiction, and subject matter jurisdiction and to ignore Congress's unambiguous statutes *specifically denying* access to those litigants and issues, then they are certainly now empowered to create standing, personal jurisdiction, and subject matter jurisdiction where Congress's statutes are *silent* or ambiguous as to the permitted litigants and issues.

3. The Federal Circuit Creates Direct Inter- and Intra-Circuit Conflicts as to Affected Item Classification and Jurisdiction to Resolve Disputes

The opinion below directly conflicts with the D.C. Circuit in *Petaluma*[56] as to

(i) TEFRA's classification of items having both partnership item elements and non-partnership item elements (as either partnership items or affected items), and

(ii) TEFRA's jurisdictional framework to resolve refunds attributable to such items.

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[56] *Petaluma*, at App.111-126.

It also creates a direct intra-circuit conflict with *Jade Trading*[57] on those issues.

Based on its erroneous analysis as to affected items, the opinion below directly conflicts with the Second Circuit in *Field* as to the proper classification of §6621(c) and the jurisdictional forum for §6621(c) refunds. The Second Circuit's narrow interpretation of §7422(h) mirrored its prior approach to another affected item (§6224(c)(2) consistent settlements) in *Monti*.[58] The Federal Circuit adopted that narrow interpretation of §7422(h) in *Prochorenko*[59] but disregarded below.

a. The Federal Circuit's Opinion Below Directly Conflicts with the D.C. Circuit's Opinion in *Petaluma* and Its Own in *Jade Trading*

In January 2010, in *Petaluma* the D.C. Circuit held that under TEFRA a partner's outside basis in his partnership interest is an affected item – not a partnership item – because it has both partnership item elements

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[57] *Jade Trading*, at App.91-110.

[58] *Monti v. U.S.*, 223 F.3d 76, 82-3 (2nd Cir.2000).

[59] *Prochorenko v. U.S.*, 243 F.3d 1359, 1363 (Fed.Cir. 2001).

and non-partnership item elements. App:122-24. On appeal, the government conceded basis is an affected item. App:122. However, it asserted the Tax Court, nevertheless, had jurisdiction over each partner's basis in the partnership-level suit because "basis is an affected item whose elements are mainly or entirely partnership items" and, therefore, "the Tax Court had jurisdiction to state the 'obvious conclusion' that a partner cannot have any basis ...." App:122. The D.C. Circuit forcefully disagreed:

> [T]he question is not whether the Tax Court's determination was correct, but whether the Tax Court had jurisdiction to make that determination at all in this partnership-level proceeding.
>
> [T]he partners' outside bases are affected items, not partnership items. Unlike partnership items, affected items are determined . . . at the individual partner level . . . .
>
> Under §6226(f), the Tax Court had jurisdiction to determine partnership items, but it did not have jurisdiction to determine affected items. We . . . reject the Commissioner's contention that outside basis, although it is an affected

> item, could nonetheless be determined in the partnership-level proceeding. **The fact that a determination seems obvious or easy does not expand the court's jurisdiction beyond what the statute provides. In other words, it does not matter how low the fruit hangs when one is forbidden to pick it.**

App:122-24. Emphasis added, citation omitted.

The D.C. Circuit upheld 25 years of consistent precedent that held partnership-level suits can determine partnership item *elements* of affected items, but the affected items *themselves* can be addressed only in later partner-level proceedings.

The D.C. Circuit correctly recognized TEFRA's bifurcated jurisdiction and procedures neither duplicate proceedings nor undermine Congress's attempts to give the IRS some, *albeit* limited, administrative relief because the partnership items are not re-determined in each partner-level proceeding. Rather, they are *res judicata* and are merely *applied* consistently to each partner's non-partnership item elements to determine his

affected item.[60]

In March 2010, the Federal Circuit in *Jade Trading* formally adopted the D.C. Circuit's *Petaluma* affected item analysis.[61] App:105-07. Below, the Federal Circuit ignored this established framework to instead hold

- as to limitations that

  (i) when the partnership item (§6229) and non-partnership item (§6501) elements of a partner's assessment deadline are combined they create a partnership item not an affected item,[62]

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[60] *Petaluma*, at App:123-24; see also *N.C.F. Energy*, 89 T.C. at 745-47; *Dial USA*, 95 T.C. at 6.

[61] The Federal Circuit had previously relied on this same affected item framework to determine that a partner's right to a §6224(c)(2) consistent settlement is not a partnership item. *Prochorenko*, 243 F.3d at 1362-63, relying on *Monti*, 223 F.3d at 82-83. Between *Petaluma* and *Jade Trading*, the Ninth Circuit adopted this same analysis to classify and determine affected items with regard to innocent spouse protection. *Adkison v. C.I.R.*, 592 F.3d 1050, 1056 (9th Cir. 2010).

[62] App:16-17.

(ii) partners are required to obtain and preserve in partnership item proceedings determinations as to every partnership item and non-partnership item element of their assessment deadline that the IRS may later seek to rely on as a defense to that partner's limitations period, without regard to who actually bears the burden to prove each element or whether the court has subject matter jurisdiction to determine the non-partnership item elements,[63] and

(iii) for pre-1997 tax years, the Tax Court's "practice" was sufficient to create personal jurisdiction over partner's with expired assessment deadlines and subject matter jurisdiction over non-partnership item elements of those deadlines, such that the Pratis were required "to participate in the partnership-level proceedings to litigate the statute of limitations

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[63] App:16-17.

issue."[64]

- as to penalty interest, the Federal Circuit conducted no analysis as to whether penalty interest is itself a partnership item or affected item but merely held that to now determine in a partner-level refund suit whether Treas. Reg. §301.6621-2T, A-5 was properly applied to any prior partnership item determinations of the "character" or "nature" of the partnership activities would be a direct challenge to those prior determinations and, therefore, jurisdictionally barred by §7422(h).

The Federal Circuit was wrong on the law and the facts.

As matter of law, barring constitutional concerns, Congress controls the jurisdiction (both personal and subject matter) of federal courts. The Article I Tax Court and CFC and the Article III federal district courts cannot by their mere "practice" create the exact jurisdiction and standing, as applicable, that Congress *expressly* and unambiguously forbade. See the separate discussions as to the

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[64] App:17.

separation of powers and standing.

The Federal Circuit was also wrong on the facts. It erroneously relied on *Rhone-Poulenc*[65] to evidence the Tax Court's practice prior to the 1997 §6226 amendments. App:17. First, *Rhone-Poulenc* was issued in 2000, it could hardly evidence the Tax Court's "practice" before 1997. Second, in that partnership-level suit the Tax Court's personal and subject matter jurisdiction to determine a partner's non-partnership item elements of his §6501(a) period were *not in dispute* and the Tax Court expressly relied on the language of the 1997 amendment to §6226(d)(1)(B),[66] it never addressed the language of pre-1997 §6226(d) and (f).

Before *Rhone Poulenc* the Tax Court had *never* held that partners could raise the §6501(a) non-partnership item element, or any other non-partnership item element, of their assessment deadline in a partnership-level suit. The Federal Circuit below and the Tax Court in *Rhone Poulenc* relied on *Columbia Bldg.*, where the IRS and all participating

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[65] *Rhone-Poulenc Surfactants & Specialties, L.P. v. C.I.R.*, 114 T.C. 533 (2000).

[66] *Id.*, at 535 and fn. 4.

partners agreed that "the statute of limitations on assessment has expired because no FPAA was sent . . . ."[67] There the Tax Court allowed those partners to side-step §6226(d)(1)(B)'s flat ban and participate but *only* to address §6229(a),[68] which was considered by most at that time (mistakenly in hindsight) to be a separate statute of limitations for assessments attributable to partnership items.[69]

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[67] *Columbia Bldg., Ltd. v. C.I.R.*, 98 T.C. 607, 611-12 (1992).

[68] *Id.* ("[W]e have considered the application of section 6226(d)(2) to this case and conclude that it would not preclude petitioner from litigating a statute of limitations defense which is applicable to ALL partners due to respondent's failure to issue a timely FPAA." Emphasis in original.).

[69] In 1991, the Tax Court held §6229(a), not §6501(a), was the only statute of limitations for assessments attributable to partnership items. *Cambridge Res.*, 97 T.C. at 292; *see also Foam Recycling Assoc. v. C.I.R.*, T.C.Memo 1992-645, 1992 WL 316474, *2; *Boyd v. C.I.R.*, 101 T.C. 365, 370 (1993); *Medical & Bus. Facilities, Ltd. v. C.I.R.*, T.C.Memo 1994-38, 1994 WL 26313, *7-*8. This position remained unchanged until the Tax Court issued *Rhone-Poulenc* in 2000.

For 25 years all affected items were resolved under TEFRA's statutory framework, including §6621(c) penalty interest,[70] §6653 negligence penalties,[71] carrybacks,[72] basis,[73] and even innocent spouse status.[74] The Federal Circuit offers no explanation for failing to follow the established affected item framework outlined by the D.C. Circuit in *Petaluma* and its own binding precedent in *Jade Trading* and to instead retroactively create procedures and jurisdiction that it asserts the Pratis should have followed 20 years ago.[75]

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[70] *Affiliated Eqmt.*, 97 T.C. at 579; *McGann* v. U.S., 76 Fed.Cl. 745, 754 (2007); *N.C.F. Energy*, 89 T.C. at 745-46.

[71] *N.C.F. Energy*, 89 T.C. at 745; *Maxwell*, 87 T.C. at 791.

[72] *Maxwell*, 87 T.C. at 790.

[73] *Id.*, at 791; *Petaluma*, at App:122-23; *Jade Trading*, at App:104-08.

[74] *Adkison*, 592 F.3d at 1056.

[75] This kind of judicially created exception to a complex Congressionally mandated statutory scheme is exactly what this Court forbids. *Freytag*, 501 U.S. at 873-74, quoting *Hallstrom v. Tillamook*

The level of error of the Federal Circuit's new analysis is evidenced by the sheer number of established legal doctrines that must be disregarded for it to stand. As to limitations, the Federal Circuit impermissibly:

- overlooked Congress's unambiguous effective date for its 1997 amendments to §6226(d)(1) and (f);[76]
- repealed pre-1997 §6226(d)(1)(B) and (f) by implication;[77]

County, 493 U.S. 20, 27 (1989).

[76] Congress's effective dates are neither meaningless nor optional. *Lockheed Corp. v. Spink*, 517 U.S. 882, 896-97 (1996). The Tax Court specifically holds that courts may not ignore the effective dates of the 1997 TEFRA amendments. *Ochsner v. C.I.R.*, T.C.Memo 2010-122, 2010 WL 2220305, *5 (June 3, 2010); *Williams*, 2009 WL 1884150, at *2, citing *Fears v. C.I.R.*, 129 T.C. 8, 10 (2007). Retroactivity to circumvent Congress's express effective date is not allowed. *Lapuh v. Merit Systems Protection Bd.*, 284 F.3d 1277, 1281-82 (Fed.Cir. 2002), citing *Landgraf v. USI Film Prods.*, 511 U.S. 244, 265 (1994).

[77] Congress's express, prospective effective date is hardly the clear, manifest evidence of intent to repeal required for a repeal by implication. *T.V.A.*

- rendered pre-1997 §6226(d)(1)(B) and (f) superfluous, void and insignificant;[78]
- caused absurd results;[79] and

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v. Hill, 437 U.S. 153, 189-90 (1978); *Hawaii v. Office of Hawaiian Affairs*, 556 U.S. —, 129 S.Ct. 1436, 1444-45, 173 L.Ed.2d 333 (2009). Congress's effective date also evidences its concern that the rules not be changed mid-stream in then-pending suits.

[78] *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001); *Freytag*, 501 U.S. at 873-74, 877, quoting *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 562 (1990).

[79] The Federal Circuit's holding bars refund jurisdiction over *all* partnership-related §6501(a)-based claims because every one has a §6229(a) partnership item element, including claims attributable to the IRS's failure to assess within one year *after* the partnership-item proceeding (whether a partnership-level suit or partner-level settlement) becomes final. §§6229(d) and (f) and §6231(b). App:166-67, 177. Under the Federal Circuit's analysis the partners must raise *every* non-partnership item element of their §6501(a)-based assessment deadline in the partnership item proceeding, even those that cannot occur until after that proceeding is concluded.

- authorized courts to dismiss taxpayer claims because the taxpayer cannot meet the government's burden of proof;[80]

- conflicts with the Fifth Circuit's recognition in *Curr-Spec* that whether assessments in the FPAA year are time-barred is irrelevant to whether the IRS can still assess in later tax years, *e.g.*, related to carryovers into later tax years with open assessment periods.[81]

As to penalty interest, the Federal Circuit below directly conflicts with and failed to apply the established *Petaluma* affected item analysis it had recently adopted in *Jade Trading*, directly conflicting with the Second

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[80] The government bears the burden to prove any exception it relies on to the normal §6501(a) assessment deadline. *Armes v. C.I.R.*, 448 F.2d 972, 974 (5th Cir. 1971). But see *Matthews v. U.S.*, 2010 WL 2305750 *4 (S.D.Tex. 2010) (relying on *Prati* to hold that district courts have no jurisdiction to consider "a taxpayer's §6501(a) limitations issue in a refund proceeding where, as here, the United States asserts §6229(a) as a basis to extend the statute of limitations").

[81] *Curr-Spec*, at 399-400.

Circuit in *Field* (on jurisdiction). The opinion below cannot be reconciled with *Field*, *Petaluma*, or even *Curr-Spec* and these direct conflicts need to be resolved once and for all by this Court.

b. The Federal Circuit's Opinion Directly Conflicts with the Second Circuit's Opinion in *Field* Regarding the Affected Item Classification and Refund Jurisdiction of Penalty Interest

In 2003, the Second Circuit held in *Field*, where partners, as here, claimed a refund attributable to §6621(c) penalty interest, that under TEFRA penalty interest is an affected item, not a partnership item, §7422(h) cannot bar the exercise of existing refund jurisdiction in partner-level suits.[82]

The Second Circuit held penalty interest cannot meet the §6231(a)(3) definition of a partnership item because it is in subtitle F, not subtitle A, and is not designated as a

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[82] *Field*, 328 F.3d at 59. Like the Deegans, the Fields also argued they were due a refund of §6621(c) penalty interest. App:87-90.

partnership-item by regulation.[83] The court relied on established precedent that held penalty interest is an affected item excluded from partnership-level jurisdiction.[84] The Second Circuit noted the government's concession at oral argument that §6621(c) "is not a partnership item but rather is properly considered an affected item". It held the "plain language of [§7422(h)] indicates that for jurisdiction to be foreclosed, the refund (not the item which leads to that refund) must be attributable to partnership items." Relying on the Fifth Circuit's analysis in *Alexander*, the Second Circuit held §7422(h) does not bar refund jurisdiction in partner-level suits where the refund is not attributable to the assessment of a partnership item but is instead attributable to an affected item (penalty interest in *Field*, limitations on assessment in *Alexander*).[85]

Prati never addressed whether penalty interest is a partnership item or an affected item. Rather, as to jurisdiction, it held that

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[83] *Id.*

[84] *Id.*

[85] *Field*, at 59, *citing Alexander*, 44 F.3d at 331-33. App:87.

partner-level review of whether Treas. Reg. §301.6621-2T, A-5 was properly applied using previously determined partnership items is a *per se* challenge to those prior determinations and requires that they be re-determined, which §7422(h) bars jurisdiction to do.

But the Deegans never challenged any prior partnership item determinations. They asked that the regulation be applied to the Tax Court agreed decision (if they were bound by it) and that the court make a determination if any amount of the assessed underpayment was properly "attributable to" one of the TMTs defined by statute or regulation.

The Federal Circuit directly and specifically conflicts with and cannot be reconciled with the Second Circuit in *Field*.

4. **The Federal Circuit's Opinion Below Also Cannot be Reconciled with Other Circuit Precedent Regarding Post-TEFRA Partnership-Level Review of §6621(c) Assessments**

In *Keller* the Ninth Circuit held that in a subsequent partner-level proceeding the court may and should address whether §6621(c) can

be applied.[86] *Keller* noted that failure to provide a post-partnership-level forum for review would leave taxpayers with no possible review of penalty interest. It also conflicts with the Sixth Circuit's holding in *Barlow* that the lack of a *pre*-payment forum to challenge §6621(c) penalty interest does not violate taxpayer Fifth Amendment due process rights because taxpayers have a *post*-payment refund forum.[87] In *Keller* the Ninth Circuit looked to the lower court findings to see if they supported the imposition of §6621(c).

Similarly, in *Copeland*, the Fifth Circuit recognized claims based on whether the determined partnership-item grounds for adjustment are sufficient to impose §6621(c) challenges whether §6621(c) should be imposed at all, not the merits of the underlying partnership-item adjustments.[88]

Other trial courts in the Fifth and Federal

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[86] *Keller v. C.I.R.*, 568 F.3d 710, 722-4 (9th Cir. June 3, 2009).

[87] *Barlow v. C.I.R.*, 301 F.3d 714, 722 (6th Cir. 2002).

[88] *Copeland v. C.I.R.*, 290 F.3d 326, 333-39 (5th Cir. 2002).

Circuits have also ordered refunds based on claims that partnership-item determinations made at the partnership-level by the Tax Court did not support §6621(c).[89] The government dismissed its appeals in both *McGann* and *Bartimmo*.[90]

Like the Pratis, the Deegans assert the IRS improperly imposed penalty interest interest in contravention of the formula set out in Treas.Reg. §301.6621-2T,A-5.[91]

The Federal Circuit acknowledged that the Pratis alleged their claim was based on violation of the regulation but avoided review of application of the regulation, holding the Pratis' claim was "disingenuous" and if the "regulation based argument" was accepted it

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[89] *Bartimmo v. U.S.*, 525 F.Supp 2d 879 (S.D.Tex. 2007); *McGann*, 81 Fed.Cl. at 655.

[90] *Bartimmo*, appeal dismissed March 12, 2008 (5th Cir. #08-20060); *McGann*, appeal dismissed July 29, 2008 (Fed. Cir. 08-5086).

[91] This formula is almost identical formula to the one established by Congress in the legislative history for §6659, another accuracy related penalty, and precedent for the two provisions is used interchangeably. *See, Todd*, 862 F.2d at 544 and n.14.

would be "inherently a dispute over the proper characterization of the partnerships' transactions" which issue is barred by §7422(h). App:82. This disregards over 20 years of unanimous precedent[92] and the IRS's official litigating position regarding the regulation.[93] In short, the Federal Circuit acknowledged the regulation applied but ignored it, contending the claim inherently challenged the transactions' characterization.

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[92] *See, Alpha I, L.P. v. U.S.*, 84 Fed.Cl. 622, 626-33 (2008) (Hewitt, C.J. construing §6621(c) and §6659 precedent); *McGann v. U.S.*, 81 Fed. Cl. 642, 650-55 (2008) (Lettow, J. construing §6621(c) and §6659 precedent); *Todd*, 862 F.2d at 544 and n.14 and *Todd v. C.I.R.*, 89 T.C. 912, 916-18 (1987); *Heasley v. C.I.R.*, 902 F.2d 380 (5th Cir. 1990); *McCrary v. C.I.R.*, 92 T.C. 827, 857-60 (1989); *Irom v. C.I.R.*, 866 F.2d 545, 547-8 (2nd Cir. 1989); *Gainer*, 893 F.2d 225 (9th Cir. 1990); *Borgardus v. U.S.*, 956 F.2d 277 (10th Cir. 1992) (unpub.), *citing Todd* and *Gainer* and *aff'g* 1990 WL 259675 (W.D. Ok.1990).

[93] 1989 IRS Litigation Guideline Memorandum, 1989 WL 989830 (August 7, 1989); 1992 IRS Litigation Guideline Memorandum, 1992 WL 1355877 (August 12, 1992).

The splits between the Federal Circuit (*Prati*) and the other circuits as to partner-level §6621(c) refund jurisdiction cannot be reconciled and have left hundreds of similarly situated partners with diametrically different outcomes respecting the same penalty interest claims.

In *Prochorenko*, the Federal Circuit followed the Second Circuit (*Monti*) but here, inconsistently, did not. While *Prochorenko* and *Monti* construed §6224(c)(2) consistent settlements, not penalty interest, they relied on many of the same factors as *Field* to find that §6224(c)(2) settlements are affected items. There the Federal Circuit recognized that while the partner might seek a refund of partnership-related taxes, the refund is not necessarily "attributable to partnership items" because "at some level of generality, most refund claims for partnership taxes can be characterized as a refund 'attributable to partnership items,' " but construing that phrase so broadly would be contrary to the system of separate treatment of partnership items and nonpartnership items established by Congress in TEFRA.[94]

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[94] *Prochorenko*, 243 F.3d at 1363 *citing Monti*, 223 F.3d at 82-83.

Although §6621(c) was repealed years ago, the jurisdictional issues affecting the Deegans' claim are not unique to §6621(c) and will continue to plague partnership-related tax litigation. The affected item at issue in *Petaluma* and *Jade Trading* was the partner's outside basis. The issue in *Adkison* was §6015 innocent spouse relief. And as mentioned above, §6621(c) is closely related to another penalty, §6659, which was essentially incorporated into the current §6662 accuracy-related penalty. The Federal Circuit is also inconsistent with recent §6662 and §6664 decisions. For example, in the *Alpha I* litigation the CFC considered jurisdiction over §6662 and the §6664 defense to those penalties after the taxpayer/partner settled with the IRS. That court recognized §6662 is the successor to §6659 and held the partner was not subject to the §6662 penalty.[95] That court also held the penalty was an affected item to be addressed at the partner level and not encompassed by §6226 partnership-item

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[95] *Alpha I, ex rel Sands v. U.S.*, 89 Fed. Cl. 347, 353 - 306 and n.2 (2009), discussing and relying on *Heasley, McCrary*, and *Rogers v. C.I.R.*, 60 T.C.M. (CCH) 1386, 1394 (1990).

jurisdiction.[96]

In *Monti* and *Prochorenko*, the Second and Federal Circuit followed *Field*'s narrow reading of §7422(h), rejecting the government's overbroad approach now adopted by the Federal Circuit below, to hold that claims indirectly related to or "capable of" being attributable to partnership items are not barred by §7422(h). Those Circuits realized that at some level every partnership-related refund claim is attributable to a partnership item but such an overbroad reading is contrary to TEFRA's structure, which recognizes individual partner rights and causes of action, *e.g.*, disputes regarding affected items (be they consistent settlements, penalty interest, limitations on assessment, etc.).

In *dicta*, the Federal Circuit's opinion below erroneously subverted the Deegans' ability to prove the intended meaning of the agreed decision. After first finding it had no jurisdiction to consider the issue, the Federal Circuit erroneously opined that the Tax Court decisions "clearly equated lack of economic

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[96] *Alpha I, ex rel Sands*, 89 Fed. Cl. at 353-60 (recognizing certain penalties and their calculations occur at the partner level).

substance with 'sham transaction' by specifically citing I.R.C. §6621(c)(3)(A)(v). . . ."

Aside from the legal question of whether a judicial finding of "lack of economic substance" and "sham" have identical meanings, which this Court has declined to review several times[97] and *which it is not asked to review here*, the use of "lack of economic substance" in the agreed decision was extensively negotiated between the IRS and the TMP on behalf of the partners and is at best ambiguous. That agreed decision was entered pursuant to a settlement between the government and the TMP. Agreed decisions result not from

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[97] In the past decade, at least five petitions for *certiorari* have asked for guidance regarding the lack of economic substance and sham transaction doctrines. *Duffie*, *cert. denied*, -- S.Ct. --, 2010 WL 3218097 (2010); *Cemco Investors, L.L.C. v. U.S.*, 515 F.3d 749 (7th Cir. 2007), *cert. denied*, 129 S.Ct. 131 (2008)(petition at 2008 WL 2724494); *Dow Chem. Co. v. U.S.*, 435 F.3d 594 (6th Cir. 2006), *cert. denied*, 127 S.Ct. 1251 (2006)(petition at 2006 WL 2827288); *Coltec Ind., Inc. v. U.S.*, 454 F.3d 1340 (Fed.Cir.2006), *cert. denied*, 127 S.Ct. 1261 (2006) (petition at 2006 WL 3295204); *Winn-Dixie Stores, Inc. v. C.I.R.*, 254 F.3d 1313, 1316 (11th Cir. 2001), *cert. denied*, 122 S.Ct. 1537 (2002)(petition at 2002 WL 32135968).

adjudication but from contractual agreement of the parties and are enforced according to the intent of the parties.[98] Likewise, tax settlements are contracts enforced using general principles of contract law and are interpreted based on the intent of the parties.[99] The common-law rule of contract interpretation is that a court should construe ambiguous language against the interest of the drafting party.[100]

The Deegans have never been given the

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[98] 18A C. Wright, A. Miller, & E. Cooper, Federal Practice and Procedure § 4443, p. 257 (2d ed.2002).

[99] *Alexander,* 44 F.3d at 331; *Treaty Pines Inv. Partnership v. C.I.R.*, 967 F.2d 206, 211 (5th Cir. 1992).

[100] Restatement (Second) of Contracts §206; *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62-3, 115 S.Ct. 1212, 1219, (1995), *citing United States v. Seckinger,* 397 U.S. 203, 210, 90 S.Ct. 880, 884-85, 25 L.Ed.2d 224 (1970), *citing American Stevedores, Inc. v. Porello*, 330 U.S. 446, 457-458, 67 S.Ct. 847, 91 L.Ed. 1011 (1947)(case remanded following representations that further evidentiary proceedings before the trial court would shed light on the intent of the parties).

opportunity to prove through extraneous documents and testimony what the intent of the parties was. Should this Court rule the Deegans were parties to the Tax Court proceedings and they do not prevail on their limitations defense, the Deegans expect to prove the intent of the parties was that the reference to "economic substance" was not intended to equate to sham and the settlement and decision were carefully drafted to avoid a stipulation to sham or any other basis for imposing §6621(c). The Deegans ask this Court to instruct the Federal Circuit to remand this case to the CFC for a determination consistent with the intent of the parties.

CONCLUSION

The fractures caused by the opinion below results from the Federal Circuit's failure to heed the Fifth Circuit's warning:

> This court and others have balked in the past at revision of the tax code to reach what appears to be a more sensible result.... Courts are particularly ill-equipped to overhaul complicated tax provisions whose function in the general

tax scheme is often beyond their ken.[101]

Rather than exercising the judicial self-restraint required within our democratic system of government, the Federal Circuit instead chose to second-guess Congress's policy decisions, even though no constitutional concern was implicated.

TEFRA's procedural complexity should not be used to cover what is, when exposed, a frontal assault on the separation of powers that would retroactively deny partners access to now raise *any* affected item defense in a refund forum.

A writ of certiorari should be granted to rein-in this judicial overreach and restore to all partners in all partnerships subject to TEFRA access to the affected item refund forum intended by Congress and previously recognized for 25 years.

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[101] *Transco Exp. Co. v. C.I.R.*, 949 F.2d 837, 840-41 (5th Cir. 1992), citations omitted.

Respectfully submitted.

Sallie W. Gladney
Counsel of Record
Thomas E. Redding
Teresa J. Womack
Redding & Associates, P.C.
2914 West T.C. Jester
Houston, TX 77018
(713) 965-9244
Counsel for Petitioners

NOVEMBER 2010

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UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

NOTICE OF ENTRY OF
JUDGMENT ACCOMPANIED BY OPINION

OPINION FILED AND JUDGMENT ENTERED: 05/05/10

The attached opinion announcing the judgment of the court in your case was filed and judgment was entered on the date indicated above. The mandate will be issued in due course.

Information is also provided about petitions for rehearing and petitions for rehearing en banc. The questions and answers are those frequently asked and answered by the Clerk's Office.

Costs are taxed against the Appellant(s) under Rule 39. The party entitled to costs is provided a bill of costs form and an instruction sheet with this notice.

The parties are encouraged to stipulate to the costs. A bill of costs will be presumed correct in the absence of a timely filed objection.

Costs are payable to the party awarded costs. If costs are awarded to the government, they should be paid to the Treasurer of the United States. Where costs are awarded against the government, payment should be made to the person(s) designated under the governing statutes, the court's orders, and the parties' written settlement agreements. In cases between private parties, payment should be made to counsel for the party awarded costs or, if the party is not represented by counsel, to the party pro se. Payment of

costs should not be sent to the court. Costs should be paid promptly.

If the court also imposed monetary sanctions, they are payable to the opposing party unless the court's opinion provides otherwise. Sanctions should be paid in the same way as costs.

Regarding exhibits and visual aids: Your attention is directed to FRAP 34(g) which states that the clerk may destroy or dispose of the exhibits if counsel does not reclaim them within a reasonable time after the clerk gives notice to remove them. (The clerk deems a reasonable time to be 15 days from the date the final mandate is issued.

JAN HORBALY
Clerk

cc: Sallie W. Gladney
Deborah K. Snyder

PRATI V US, 2008-5117
CFC, 02-CV-060

App. 3

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

2008-5117

RONALD C. PRATI and MARY G. PRATI,
Plaintiffs-Appellants,

v.

UNITED STATES,
Defendant-Appellee.

- -

2008-5129

EDWARD J. DEEGAN and JOAN S. DEEGAN,
Plaintiffs-Appellants,

v.

UNITED STATES,
Defendant-Appellee.

Thomas E. Redding, Redding & Associates, P.C., of Houston, Texas, argued for all plaintiffs-appellants. With him on the brief were Sallie W. Gladney and Teresa J. Womack.

Deborah K. Snyder, Attorney, Tax Division, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With her on the brief were John A. DiCicco, Acting Assistant Attorney General, and Michael J. Haungs, Attorney.

Appealed from: United States Court of Federal Claims

Judge Lawrence J. Block

App. 4

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

2008-5117

RONALD C. PRATI and MARY G. PRATI,
Plaintiffs-Appellants,

v.

UNITED STATES,
Defendant-Appellee.

Appeal from the
United States Court of Federal Claims
in 02-CV-060, Judge Lawrence J. Block.

2008-5129

EDWARD J. DEEGAN and JOAN S. DEEGAN,
Plaintiffs-Appellants,

v.

UNITED STATES,
Defendant-Appellee.

Appeal from the
United States Court of Federal Claims
in 06-CV-594, Judge Lawrence J. Block.

DECIDED: May 5, 2010

Before RADER, BRYSON, and MOORE, Circuit Judges.

BRYSON, Circuit Judge.

These two federal tax cases raise complex questions pertaining to the taxation of transactions involving partnerships. Our analysis is relatively straightforward, however, because prior decisions of this court in related cases have dealt with and resolved several of the issues that are before us in these cases. Those decisions largely dictate the results we reach here.

I

The dispute in these cases relates to a number of limited partnerships managed by American Agri-Corp ("AMCOR"), a corporation that promoted tax shelter partnerships during the 1980s. The partnerships were designed to generate a large loss in the first year, allowing each partner to claim a tax deduction averaging twice the size of his investment, with the excess loss to be recaptured in subsequent years. Appellant Ronald Prati and his wife invested in three of the AMCOR partnerships, while appellant Edward Deegan and his wife invested in another AMCOR partnership. In 1985, the partnerships filed tax returns claiming an ordinary loss deduction; the Pratis and the Deegans used those losses on their individual tax returns to offset their taxable income for that year.

The Internal Revenue Service began investigating the AMCOR partnerships in 1987. It subsequently issued Notices of Final Partnership Administrative Adjustment ("FPAAs") to 43 partnerships in 1990 and

1991 with respect to their 1985 returns. The FPAAs disallowed the deductions for several reasons, including that the partnership activities constituted a series of "sham transactions."

Representatives of the partnerships challenged the FPAA disallowances in partnership-level proceedings before the Tax Court pursuant to 26 U.S.C. ("I.RC.") §6226(b). Among the issues litigated was whether the adjustments were barred by the statute of limitations. The parties selected a number of test cases, and each partnership signed a "Stipulation to be Bound" in which it agreed that "the outcome of the statute of limitations issue present in this Partnership Case will be determined in a manner consistent with the [Tax] Court's findings of fact and law on the statute of limitations issue present in the Test Case Group case of Agri-Venture Fund." In 2000, the Tax Court rejected the statute of limitations defense in the test cases, finding that one of the partnerships had failed to file a valid partnership return and that the other four had validly agreed through their tax matters partners ("TMPs") to extend the time period pursuant to I.RC. §6229(b). See Agri-Cal Venture Assocs. v. Cornm'r, 80 T.C.M. (CCH) 295 (2000).

While those partnership-level suits were pending, some partners (including the Pratis) chose to settle their partnership items. The IRS accepted those settlements in April 1997 and assessed the applicable taxes and interest. As part of the assessment, the IRS sought additional interest pursuant to former I.RC. §6621(c), a special interest provision for "substantial underpayments attributable to tax motivated

transactions." That statute defined "tax motivated transactions" to include "any sham or fraudulent transaction." I.R.C. §6621(c)(3)(A)(v) (repealed 1989). After paying the assessments in full, the Pratis filed partner-level administrative refund claims with the IRS in April 1999. The IRS disallowed those refund claims as precluded by I.R.C. §7422(h), which provides that "[n]o action may be brought for a refund attributable to partnership items." In 2002, the Pratis filed a refund action in the Court of Federal Claims.

Meanwhile, in 2001, the IRS moved under Tax Court Rule 248(b) for entry of decision in the remaining partnership cases. The IRS's motion represented that the IRS and the TMPs for the AMCOR partnerships had reached contingent agreements with respect to all the disputed partnership items, and that all partners meeting the interest requirements of I.R.C. §6226(d) would be deemed parties bound by the entered decisions. In accordance with that motion, the Tax Court entered stipulated decisions on July 19,2001. The IRS then assessed taxes and section 6621(c) interest against those partners who had not settled with the IRS (including the Deegans). The Deegans paid the assessments in full and then filed administrative refund claims with the IRS in 2004. The IRS disallowed the claims, and the Deegans filed suit in the Court of Federal Claims in 2006.

A total of 129 AMCOR-partnership tax refund cases were filed by various taxpayers in the Court of Federal Claims. Of those, the taxpayers identified 77 as being factually and legally similar. The parties selected the

Prati case to serve as a representative case, and the trial court stayed the remaining 76 of the 77 similar cases pending its decision in that case.

In Prati, the taxpayers raised two primary claims for relief: first, that the assessments were untimely because they were made after the statute of limitations had expired; and second, that the assessments of section 6621(c) interest were improper because the partnership transactions at issue were not tax-motivated transactions. The government responded that in light of the prohibition in section 7422(h) against bringing a refund action for a refund "attributable to partnership items," the trial court lacked jurisdiction to hear either claim because both claims were partnership items that should have been challenged in the partnership-level proceeding instead of in partner-level proceedings.

In April 2008, the trial court dismissed the Pratis' claims for lack of subject matter jurisdiction pursuant to section 7422(h). The court also ordered the dismissal of the 76 cases that the parties had identified as presenting identical claims, including the Deegan case. The court relied heavily on the reasoning in Keener v. United States, 76 Fed. Cl. 4455 (2007), which had already considered the same claims in the context of section 7422(h) and which was on appeal to this court at that time.

Following the trial court's decision in Prati, the taxpayers filed a motion for reconsideration requesting, inter alia, that the judgments be vacated in all 77 related cases. They asserted that the cases should either be stayed pending this court's decision in

Keener, which the taxpayers stated would be "binding" on all 77 cases, or be consolidated so that the cases could proceed as a single appeal. They argued that doing so would avoid unnecessary appeals and preserve the resources of the parties and the court. The trial court denied the motion.[1]

The taxpayers filed appeals in 57 cases and then moved to stay those appeals pending this court's decision in Keener.[2] In support of that motion, the taxpayers again expressed their belief that "this Court's holdings in Keener should resolve the jurisdictional issues on appeal in all 58 cases." The motions to stay were granted.

On January 8, 2009, this court issued its opinion in Keener affirming the dismissal of the plaintiffs' claims for lack of jurisdiction. Keener v. United States, 551 F.3d 1358 (Fed. Cir. 2009). The government then moved for summary affirmance in all the related cases. This court denied the government's motions without prejudice, so as to permit the taxpayers to present argument as to why Keener should not control the disposition of the remaining cases. We lifted the stays in Prati and Deegan to permit them to proceed as

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[1] The trial court vacated the judgments in 17 cases in which the parties stated that additional case-specific claims were presented, but only "for the limited purpose of allowing plaintiffs to pursue any unresolved, case-specific claims that may still be outstanding."

[2] Two of those appeals were subsequently dismissed for lack of appellate jurisdiction on an unopposed motion by the government.

representative of cases involving settling partners and non-settling partners, respectively.

II

At the outset, the government argues that these appeals are barred by judicial estoppel (as to both the Pratis and the Deegans) and waiver (as to the Deegans). The government's argument is based on the way the parties litigated the large number of related AMCOR-partnership tax refund cases.

The taxpayers represented that Keener, Prati, and all the other AMCOR-partnership tax refund cases now on appeal before this court were indistinguishable with respect to the jurisdictional issues presented in those cases, and that this court's decision in Keener would resolve those issues conclusively. The government contends that the taxpayers should not be allowed to alter their position now that Keener has been decided and has rejected the arguments made by the taxpayers in that case.

We see no basis for judicial estoppel here. The Pratis and the Deegans reasonably expected that the Keener case would resolve the jurisdictional issues raised in these appeals. A representation that a pending case should be dispositive, however, does not deprive parties of the right to argue that the ensuing decision failed to settle all the issues to be resolved in their case. To apply judicial estoppel in cases such as these would raise the specter of forfeiture of appellate rights whenever a party requests a stay to allow a "representative" case to go forward separately for the purpose of resolving issues common to all of the related

cases. See Whiting v. Krassner, 391 F.3d 540, 543-44 (3d Cir. 2004) (party's request for a stay based on the likelihood that his claim would be held to be moot "is not the type of 'position' that should work an estoppel," where the position was not asserted in bad faith and was "more predictive than assertive"); Bendet v. Sandoz Pharms. Corp., 308 F.3d 907, 910 (8th Cir. 2002) (party that sought a stay based on an assertion that its evidence was "essentially the same" as the evidence in another case, was not judicially estopped from seeking to distinguish the other case after an adverse decision in that case).

The government also argues that the Deegans waived their right to argue that their case is distinguishable from the Pratis' case because the Deegans did not raise any such distinction before the Court of Federal Claims. In particular, the government contends that the Deegans did not argue that their case differs from the Pratis' case in that the Pratis entered a settlement while the Deegans did not. It is true that the non-settling partners did not argue before the Court of Federal Claims that their legal status was different from that of the settling partners. Instead, the taxpayers in all of the related cases proceeded on the assumption that their claims would be resolved by legal rulings that would apply equally to the settling and non-settling partners.

This court's decision in Keener rejected the principal arguments raised by the taxpayers in all of the related cases. In the Deegans' view, however, this court's opinion in Keener was narrower than the trial court's opinion in that case and thereby gave rise to a

potential ground for distinguishing their claims from those of the settling partners. Under those circumstances, and in light of this court's direction that briefing and argument proceed in both the Prati and Deegan cases so as to address any issues raised by the different legal status of the settling and the non-settling partners, we do not find that the failure to draw that distinction in the trial court resulted in a waiver of appellate rights.

III

Turning to the merits, the appellants argue that this court's decision in Keener did not resolve the statute of limitations claim and the section 6621(c) interest issue as applied to these cases. In particular, they argue that section 7422(h) does not bar them from litigating those two issues in the refund proceedings in the Court of Federal Claims. We disagree.

Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Pub. L. No. 97-248, §402(a), 96 Stat. 648, in order to promote consistent tax treatment of partners and to avoid duplicative litigation. Under TEFRA, the tax treatment of "partnership items" is determined in a single partnership-level proceeding. Section 7422(h) of the Code enforces that principle by prohibiting partners from bringing individual actions "for a refund attributable to partnership items . . . ." A partnership item is defined as

> any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations

> prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

I.R.C. §6231(a)(3).

In Keener, the court found that the taxpayers' statute of limitations claim was "attributable to a partnership item" and therefore was barred by section 7422(h) from being litigated in a refund action. The Keener court rejected the taxpayers' argument that "the provisions relevant to this claim—namely, §§6229(a) and 6501—are found in subtitle F of the code, rather than subtitle A, [and so] the claim cannot be considered a partnership item by definition." 551 F.3d at 1365. Because the court concluded that the statutory definition of "partnership item" was ambiguous, it looked to the definition of "partnership item" in the Treasury regulations. That definition provides that partnership items include "the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." Treas. Reg. §301.6231(a)(3)-1(b). The Keener court found that definition to be a permissible interpretation of the statutory language and thus entitled to deference under Chevron U.S.A Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984). Applying that definition to the case before it, the Keener court concluded that the definition was broad enough to encompass the taxpayers' statute of limitations claims. That result, the court noted, was consistent with "TEFRA's dual goals of centralizing the treatment of

partnership items and ensuring the equal treatment of partners." 551 F.3d at 1363-64 & n.3.

The Keener court also rejected the taxpayers' argument that section 6621(c) interest should not have been assessed against them because the transactions for which that interest was imposed were not "tax motivated transactions," as required by section 6621(c). The court observed that determining whether a particular partnership transaction is tax motivated, and specifically whether it is a "sham" transaction, turns on "the nature of the partnership's transaction," which is a partnership item. 551 F.3d at 1366. Accordingly, the court concluded that the taxpayers' challenges were "attributable to partnership items," and thus that section 7422(h) barred those challenges from being litigated in a refund action.

The Keener court also dismissed the taxpayers' contention that, by issuing FPAAs that listed multiple, independent grounds for disallowance—some that qualified as tax motivated and some that did not—the IRS failed to make any conclusive determination as to whether the partnerships' transactions were tax motivated. The court observed that, even assuming the taxpayers could raise their section 6621(c) claims in the refund proceeding, their argument would be unpersuasive because the IRS's inclusion of additional grounds for disallowance of their deductions did not somehow undermine its determination that the transactions at issue were tax motivated. Keener, 551 F.3d at 1367 (it would be inequitable "to impose penalty interest when a deduction is disallowed because the partnerships' transactions were tax

motivated, but not to impose penalty interest when that deduction is also disallowed on other inseparable grounds").

A

The appellants argue that the decision in Keener does not resolve their statute of limitations claim because they raised two independent limitations claims, under I.R.C. §6229 and I.R.C. §6501 respectively, and Keener dealt only with the section 6229 claim. For that reason, they assert, Keener did not bar the defense predicated on section 6501. Section 6501, the general statute of limitations for tax assessments against individuals, gives the IRS three years to issue an assessment from the date the taxpayer's return is filed. For partnership items, section 6229 extends that period to three years after the later of (1) the date on which the partnership return is filed, or (2) the last day for filing the partnership return for a taxable year.

The appellants base their argument on this court's recent decision in AD Global Fund, LLC v. United States, 481 F.3d 1351 (Fed. Cir. 2007), which held that section 6229 "does not create an independent statute of limitations." Id. at 1354 & n.2. According to the appellants, the significance of that holding is that section 6501 is the only applicable statute of limitations, so that a court presented with a statute of limitations defense may look only to the three-year period provided by section 6501. The section 6229 time extension is not invoked, they argue, unless it is separately asserted by the government.

We disagree with the appellants' argument. Sections 6501 and 6229 operate in tandem to provide a single limitations period. When an assessment of tax involves a partnership item or an affected item, section 6229 can extend the time period that the IRS otherwise has available under section 6501 to make that assessment. See Andantech L.L.C. v. Comm'r, 331 F.3d 972, 976-77 (D.C. Cir. 2003); Grapevine Imports, Ltd. v. United States, 71 Fed. Cl. 324, 328-39 (2006). Thus, the limitations period is the period defined by section 6501, as extended when appropriate by section 6229. Sections 6501 and 6229 do not operate independently to allow a taxpayer to assert one in isolation and thereby render an otherwise timely assessment untimely.

In Keener, the court's reasoning was directed to the statute of limitations defense as a general matter and was not limited, as the appellants contend, to section 6229. Although the Keener court referred to section 6229 and did not mention section 6501, it is clear, given the interaction between sections 6501 and 6229, that the court's reference to section 6229 was merely a shorthand way of referring to the taxpayers' overall statute of limitations claim. Thus, the Pratis and Deegans cannot distinguish their cases from Keener on the ground that Keener did not discuss section 6501.[3]

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[3] Nor is there any merit to the Pratis' argument that their settlement agreements with the IRS were comprehensive and "had no provisions extending the §6501 assessment period," because, as explained above, section 6229 does not operate independently from section 6501.

Based on Keener, we hold that the statute of limitations issue is a partnership item and that the Pratis and the Deegans were required to raise the limitations issue in the partnership-level proceeding prior to either entering settlement or stipulating to judgment in the Tax Court.[4] They did not do so, and we therefore affirm the trial court's ruling that section 7422(h) bars them from raising their statute of limitations claims in the refund proceedings.

B

The appellants next contend that Keener did not address or resolve the particular grounds on which

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[4] The appellants argue that they could not participate in the partnership-level proceeding because that action was instituted after the statute of limitations had expired as to each of them, and also because individual partners were barred from raising statute of limitations claims in partnership-level proceedings until such a procedure was expressly permitted by a 1997 amendment to the Code. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, §1239(f), 111 Stat. 788, 1028. We reject both arguments. As for the appellants' argument that they were barred from participating in a proceeding to decide whether the statute of limitations had run because the statute of limitations had already run, that argument is circular and has no merit. As for their latter contention, the 1997 amendment merely codified prior practice in the Tax Court; the appellants, as individual partners, were therefore free to participate in the partnership-level proceedings to litigate the statute of limitations issue. See Rhone-Poulenc Surfactants & Specialties, L.P. v. Comm'r, 114 T.C. 533, 535 (2000) ("[W]e have held that a partner may participate in such action for the purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired and that we have jurisdiction to decide whether that assertion is correct."); Columbia Bldg., Ltd. v. Comm'r, 98 T.C. 607 (1992).

they now challenge the penalty interest imposed against them under former section 6621(c).

One of the significant omissions in Keener, according to the appellants, was the court's failure to address Treasury Regulation §301.6621-2T, A-5. That regulation explains how to determine the amount of an underpayment that is tax motivated, which is the amount subject to penalty interest. The calculation is performed by starting with the total tax liability. taking into account all adjustments, and subtracting the amount of tax liability "[w]ithout taking into account any adjustments . . . that are attributable to tax motivated transactions." That difference yields the amount of the "tax motivated underpayment," an amount that includes any adjustments that are "attributable" to tax-motivated transactions.

The appellants contend that the Treasury regulation, as properly applied, permits section 6621(c) interest only with respect to underpayments that are "solely attributable" to a tax-motivated transaction. The Pratis, who entered into a settlement with the IRS resolving their partnership items, state that the settlement they entered did not identify the grounds for disallowance, so the settlement must be deemed to have incorporated all of the grounds listed in the FPAA. Because the finding of sham was only one of many reasons for disallowance, they argue, the underpayments were not "solely attributable" to tax-motivated transactions. Accordingly, they conclude, section 6621(c) interest should not have been imposed on them.

The problem with the appellants' argument is that the court in Keener held that a dispute over the "characterization of a partnership's transaction is a partnership item." 551 F.3d at 1365. The appellants seek to distinguish their claim by characterizing it not as a "direct challenge to sham" but instead as a "merits based defense as to why Treasury Regulation §301.6621-2T, A-5 was allegedly not violated." But that contention is disingenuous because the appellants' regulation-based argument, if accepted, would invalidate the determination that the partnerships' transactions were tax motivated. That determination, which flowed directly from the finding of sham, is equally tied to the nature of a partnership's transaction. Because the appellants' challenge to the penalty interest assessments is inherently a dispute over the proper characterization of the partnerships' transactions, that issue is barred by section 7422(h) from being litigated in the refund action before the Court of Federal Claims.

The Pratis also maintain that the settlements they entered were comprehensive and that those settlements did not include any determinations as to the nature or characterization of the partnerships' transactions. To the extent they are disputing the finding that those transactions were tax motivated, that line of argument remains barred by section 7422(h). To the extent they are suggesting that the settlement had the effect of converting all partnership items into non-partnership items and that they are thus entitled to challenge the penalty interest assessments in individual refund actions, that argument runs afoul of another one of this court's

recent AMCOR-partnership decisions, Schell v. United States, 589 F.3d 1378 (Fed. Cir. 2009). In that case, which involved similar settlement agreements, we held that, notwithstanding the settlements, "the sham-transaction issue was not converted into a non-partnership item, and the Taxpayers' refund claims necessarily involve resolution of 'partnership items.'" Id. at 1383-84.

The Deegans, whose claims were resolved by a stipulated decision in the Tax Court, argue separately that the stipulated decision attributed the disallowance of their deduction to a "lack of economic substance" in the underlying transaction, which the Deegans argue is different from a "sham transaction." Again, however, that argument is directed to the nature of the partnership transaction and therefore is barred by section 7422(h) from being raised before the Court of Federal Claims. Moreover, the Deegans' argument that the Court of Federal Claims mischaracterized the Tax Court's decision, and that the penalty issue remains open for decision in the refund action, is rebutted by the text of the stipulated decision itself. The Tax Court's decision clearly equated lack of economic substance with "sham transaction" by specifically citing I.R.C. § 6621(c)(3)(A)(v), the provision that defines tax-motivated transactions as including "any sham or fraudulent transaction."

For the foregoing reasons, we sustain the decision of the Court of Federal Claims dismissing the appellants' claims in both cases.

AFFIRMED.

In the
United States Court of Federal Claims
No. 02-60 T
July 31, 2008

RONALD C.
& MARY G. PRATI

Plaintiffs,

RCFC 42,59; Motion for Reconsideration; Motion to Vacate Judgment; Consolidation

v.

THE UNITED STATES
OF AMERICA,

Defendant.

Thomas E. Redding and *Teresa J. Womack*, Redding & Associates P.C., Houston, Texas, for plaintiffs.

Bart D. Jeffries, United States Department of Justice, Tax Division, Washington, D.C., with whom was Assistant Attorney General *Eileen J. O'Connor*, for defendant.

AMENDED ORDER AND OPINION

I. INTRODUCTION

Plaintiffs move under Rule 59 of the Rules of the United States Court of Federal Claims ("RCFC"), for reconsideration of this Court's April 16, 2008 opinion

in *Prati v. United States*, 81 Fed. Cl. 422 (2008), dismissing the claims of plaintiffs Ronald C. and Mary G. Prati and 76 other similar AMCOR cases for lack of subject matter jurisdiction. Pls.'s Mot. for Reconsideration, April 30, 2008 [Docket #89]. At the May 2, 2007 oral argument on the defendant's motion to dismiss and the parties' cross-motions for summary judgment, the parties requested that the Court first resolve the jurisdictional issues arising in the AMCOR tax partnership cases and that for such a purpose *Prati* should serve as a representative case. Tr. of Oral Argument, *Isler v. United States*, No. 01-344, May 2, 2007, at 173-79 [Docket #122]. According to the parties in their jointly-proffered chart identifying which AMCOR cases had what issues, there appeared to be 76 other AMCOR cases that shared similar jurisdictional issues as *Prati*. For efficiency sake, these cases were treated together—although never formally consolidated or combined—for the limited purpose of addressing the common legal issues in the pending motions. Supplemental Joint Chart, *Isler v. United States*, No. 01-344 [Docket #127]. Accordingly, the *Prati* decision applies to 77 of the 124 AMCOR cases

pending before this judge[1] and, therefore, the motion for reconsideration applies to the 77 as well.[2]

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[1] The 76 other cases covered by the *Prati* opinion are: Acker, Nadine (07-215); Adams, Samuel (07-162); Arumugam, Velusami (02-1395); Aylward, Thomas (06-593); Baer, Maurice (06-857); Barry, Ira (03-200); Belair, Laurence (07-588); Berman, Robert (06-856); Boland, John (06-859); Brady, Robert (07-315); Caldwell, Bruce (07-548); Cannon, Nassif, Jr. (02-61); Casamento, Stephen (06-698); Chapman, Bill (05-1225); Clinton, Tommy (04-116); Connell, Thomas (07-62); Corkill, Glen (07-147); Cox, Dean (04-709); Crocker, Jesse (04-903); Crouse, Betty (07-894); Davidson, Arthur (07-196); Davis, Charles (06-624); Davis, Robert (06-697); Davison, Robert (04-1112); Deegan, Edward (06-594); Dhillon, Charanjit (02-1477); Dvoranchik, William (07-231); Donaldson, Robert (03-2875); Dow, Ruth (06-746); Dykstra, Donald (07-309); Ehrenbard, Robert (03-1559); Fazio, Anthony (07-163); Feldman, Merrill (07-224); Fillmore Equipment (07-341); Fournier, E. Haffner (06-933); Gilbertson, Robert (05-934); Goldman, Elise (04-123); Gregory, Jane (06-578); Hackett, James III (05-758); Hastie, J. Drayton (04-291); Hatton, Richard (04-127); Huguera, Teodoro (07-381); Iannacchino, Michael (06-817); Johnson, Richard (03-2339); Johnson, Stanley (04-908); Jones, Palmer (03-2229); Jones, Thomas, Jr. (02-1079); Keefe, Joseph (07-893); Key, Scott (06-293); Lloyd, James (06-623); Ludwig, Gordon (02-1730); Lyons, Edward, Jr. (06-391); Lynn, Nancy (07-564); Marshall, Larry (02-474); Martin, Robert (03-2272); Miller, Edward (05-508); Mitchell, Lewis (07-587); Montgomery, William (03-2273); Moody, Robert (06-752); Morris, John (07-405); Northcutt, Merline (06-860); Oehlschlager, Keith (05-1144); Oldshue, Jerry (06-696); Sadd, William (05-25); Schuler, John (02-432); Sperling, Stanley (02-1523); Strauss, Joseph (06-823); Tanner, Larry (04-1066); Thompson, Richard (06-792); Ungs, Jerome (06-137); Vallari, Stephen (06-761); Vigliotta, John (02-13); Voda, Jan (06-818); Whitaker, Lloyd (02-795); Winternitz, William (01-404); Wyckoff, E. Lisk, Jr. (02-772).

[2] For efficiency, plaintiffs requested that the motion for reconsideration filed in *Prati* apply to all 77 cases covered by the

In the present motion, as an alternative, plaintiffs also request that the judgment be vacated for all 77 cases covered by the *Prati* opinion and either: (1) all the cases be stayed pending the resolution by the Federal Circuit of the jurisdictional issues in *Keener v. United States*, 76 Fed. Cl. 455 (2007), *appeal docketed*, 2008-5004 (Fed. Cir. Oct. 19, 2007), or (2) the other 76 cases be consolidated under *Prati*, the judgments be re-entered, and the cases proceed as a single appeal. Pls.'s Mot. for Reconsideration, April 30, 2008, at 2 [Docket #89].

In footnote 2 of the plaintiffs' reconsideration motion, plaintiffs' counsel represented that they would file at least four separate motions to vacate in cases covered by the *Prati* opinion because these cases had additional issues left unresolved by that decision. *Id.* Specifically, plaintiffs' counsel identified *Belair* (07-1295), *Boland* (06-859), *Cannon* (02-61), and *Wyckoff* (02-772) as being incorrectly grouped with

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Prati opinion. On June 6, 2008, the Court granted that request. Order Deeming Mot. for Reconsideration to Have Been Filed in 76 Other Cases, June 6, 2008 [Docket #93].

Subsequently, on June 18, 2008, plaintiffs individually filed identical motions styled, "Motion to Perfect the Record," in 74 of the 77 *Prati* cases. These motions seek recognition that plaintiffs' motion for reconsideration and the Court's June 6 Order are deemed filed in each of the *Prati* cases. These motions were, of course, unnecessary given the June 6 Order. Additionally, there is no such motion called a "Motion to Perfect the Record," as evidenced by plaintiffs filing their motions in the electronic case filing (ECF) system as a motion to supplement the administrative record, even though *Prati* and its brethren are not administrative record cases.

Prati (this despite the fact that the Court relied on the parties' representations that all the 76 cases covered by *Prati*—including these four—contained only the relevant jurisdictional issues). Supplemental Joint Chart, *Isler v. United States*, No. 01-344 [Docket#127].

Furthermore, on May 2, 2008, plaintiffs did indeed file separate motions to vacate—not four of them, but 15.[3] In each of the 15 cases, plaintiffs claim that partner-specific claims remain unresolved, and that the judgment should be vacated so that plaintiffs might pursue a judgment on matters not covered by the *Prati* opinion. *See, e.g., Arumgam v. United States*, No. 02-1395 [Docket #19], at 3. To add to this Gordian Knot of confusion, the 15 named cases no longer included *Cannon* and *Wyckoff*—two of the four cases in which plaintiffs' counsel had originally represented that they would include in the individual motions to vacate. Pls.' Mot. for Reconsideration at 2.

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[3] The 15 cases in which motions to vacate were filed are: Arumugam, Velusami (02-1395); Barry, Ira (03-200); Belair, Laurence (07-588); Boland, John (06-859); Corkill, Glen (07-147); Dhillon, Charanjit (02-1477); Dvoranchik, William (07-231); Donaldson, Robert (03-2875); Dykstra, Donald (07-309); Feldman, Merrill (07-224); Fillmore Equipment (07-341); Fournier, E. Haffner (06-933); Johnson, Stanley (04-908); Martin, Robert (03-2272); Northcutt, Merline (06-860). Despite their initial assertion in the motion for reconsideration, plaintiffs' counsel did not file motions to vacate in Cannon, Nassif, Jr. (02-61) or Wycoff, E. Lisk, Jr. (02-772). However, defendant conceded that there may be unresolved issues in those two cases, and does not object to the Court vacating the decisions in those two cases in order to determine if unresolved issues indeed remain outstanding.

As expected, defendant opposed the motion for reconsideration. Def.'s Resp. to Mot. for Reconsideration, May 13, 2008 [Docket #90]. Nevertheless, in its response, defendant did not object to vacating judgment in 17 cases (the 15, plus *Cannon* and *Wycoff*) because it admitted that there are apparently still-unresolved claims in those cases. *Id.* at 6-8.

To clarify matters and hopefully avoid further confusion, the Court conducted a recorded status conference by telephone on May 21, 2008. At the status conference, defendant, despite having previously stipulated to vacating the judgments in cases that apparently contained additional non-jurisdictional issues, raised an objection to vacating the judgments in two, *Dhillon* (02-1477) and *Johnson* (04-908), that plaintiffs sought to vacate. Status Conference Tr. at 13. Defendant stated that although it did not originally object to the vacating of the judgments in these two cases, after further review, defendant now believes that all the issues in these two cases were fully covered by *Prati*. *Id.*

Plaintiffs disagreed with defendant's contention that the issues in *Dhillion* and *Johnson* were covered by *Prati*, and when asked about the status of *Cannon* and *Wyckoff*, plaintiffs maintained that these cases may also have additional non-jurisdictional issues, but admitted that it was very possible that the additional issues were no longer legally viable. Status Conference Tr. at 15-17. The parties agreed that one possible solution is to vacate the judgment in 15 cases—the 15 cases in which motions to vacate were filed, minus

Dhillon (02-1477) and *Johnson* (04-908), plus *Cannon* (02-61) and *Wyckoff* (02-772). Further, plaintiffs would also respond to an "order to show cause" why *Dhillon* and *Johnson* should be vacated, and defendant would have an opportunity to reply. Status Conference Tr. at 18.

Finally, at the status conference, plaintiffs renewed their prior motion for reconsideration for all cases covered by the *Prati* opinion and their motions to vacate the judgment in all 15 of the aforementioned cases that allegedly contain additional non-jurisdictional issues. In the alternative, if the Court denies the reconsideration motion, plaintiffs asked that, in order to avoid the administrative costs of separate appeals for each judgment in those cases covered by *Prati*, the Court temporarily vacate the judgment in order to allow the consolidation of these cases for appeal of the jurisdictional issues, whereupon judgment can be re-entered upon consolidation. Status Conference Tr. at 21-23. Defendant vehemently disagreed with this approach. *Id.* at 23.

II. Discussion

A. Standard for a Motion for Reconsideration

RCFC 59(a) provides that this Court may grant a "new trial or rehearing or reconsideration . . . to all or any of the parties and on all or part of the issues, for any of the reasons established by the rules of common law or equity applicable as between private parties in the courts of the United States." It is well recognized that the decision whether to grant reconsideration lies within the discretion of the trial court. *Parsons ex rel.*

Linmar Prop. Mgmt. Trust v. United States, 174 Fed. App'x. 561, 562 (Fed. Cir.), *cert. denied*, 127 S. Ct. 323 (2006); *Yuba Natural Res., Inc. v. United States*, 904 F.2d 1577, 1583 (Fed. Cir. 1990); *see also Keeton Corrections, Inc. v. United States*, 60 Fed. Cl. 251, 253 (2004); *Paalan v. United States*, 58 Fed. Cl. 99, 105 (2003). However, this discretion is bounded by the requirement that a court must address reconsideration motions with "exceptional care." *Seldovia Native Ass'n, Inc. v. United States*, 36 Fed. Cl. 593, 594 (1996) (quoting *Carter v. United States*, 518 F.2d 1199 (Ct. Cl. 1975)), *aff'd*, 144 F.3d 769 (Fed. Cir. 1998); *Henderson County Drainage Dist. No. 3 v. United States*, 55 Fed. Cl. 334, 337 (2003).

Indeed, to prevail, a motion for reconsideration must be based "upon manifest error of law, or mistake of fact, and is not intended to give an unhappy litigant an additional chance to sway the court." *Fru-Con Constr. Corp. v. United States*, 44 Fed. Cl. 298, 300 (1999), *aff'd*, 250 F.3d 762 (Fed. Cir. 2000); *see also Six v. United States*, 80 Fed. Cl. 694 (2008); *Pacific Gas & Elec. Co. v. United States*, 58 Fed. Cl. 1, 2 (2003); *Ammex, Inc. v. United States*, 52 Fed. Cl. 555, 557 (2002), *aff'd*, 384 F.3d 1368 (Fed. Cir. 2004). Moreover, the movant must also show that: (a) an intervening change in the controlling law has occurred; (b) evidence not previously available has become available; or, (c) that the motion is necessary to prevent manifest injustice. *See Bishop v. United States*, 26 Ct. Cl. 281, 286 (1992) (citing *Weyerhaeuser Corp. v. Koppers Co.*, 771 F. Supp. 1406, 1419 (D. Md. 1991)); *see also Int'l Air Response, Inc. v. United States*, 81 Fed. Cl. 364, 366 (2008); *Bannum, Inc. v. United States*, 59 Fed. Cl. 241,

243 (2003); *Citizen Fed. Bank, FSB v. United States*, 53 Fed. Cl. 793, 794 (2002). "A court, therefore, will not grant a motion for reconsideration if the movant merely reasserts . . . arguments previously made . . . all of which were carefully considered by the court." *Ammex, Inc. v. United States*, 52 Fed. Cl. at 557 (internal quotation marks omitted).

B. The Motion for Reconsideration

Turning first to the motion for reconsideration covering all 77 cases under the *Prati* opinion, plaintiffs have failed to meet their burden for reconsideration.

Plaintiffs argue in their motion that the Court erred in its description of TEFRA and should therefore correct "certain statements in its *Prati* opinion that are incorrect as a matter of law so that it does not contribute to the confusion already existing as to TEFRA." Pls.' Mot. for Reconsideration at 3. Plaintiffs next present an argument about their tax settlement agreements with the government, insisting that the settlement agreements were "comprehensive," and thus changed the Pratis' partnership items to non-partnership items. *Id.* at 7-13. Plaintiffs then contend that the *Prati* decision is inconsistent with *McGann v. United States*, 76 Fed. Cl. 745 (2007) ("*McGann I*"), and *McGann v. United States*, 81 Fed. Cl. 642 (2008) ("*McGann II*"), and thus should be reconsidered and reversed. Pls.' Mot. for Reconsideration at 13. Finally, plaintiffs repeat fully-briefed arguments regarding tax-motivated interest, seeking a reversal of the Court's holding regarding jurisdiction. *Id.* at 14-20.

With regard to plaintiffs' TEFRA challenge, the Court notes that even if it did mischaracterize TEFRA, the alleged mischaracterization simply did not have any effect on the outcome of the case. *See A.A.B. Joint Venture v. United States*, 77 Fed. Cl. 702, 707 (2007) (no reconsideration under RCFC 59 where error, if any, is harmless). The alleged mischaracterization was part of a description of TEFRA, the relevant statutory framework, not a mistake with regard to any specific factual determinations or legal conclusions. Most notably, however, is the fact that the Court's characterization of TEFRA is factually accurate, and comports with similar descriptions of TEFRA made not just by this Court previously, but with descriptions written by the Federal Circuit, the Second Circuit, the Fifth Circuit, the Seventh Circuit, and the Eighth Circuit, just to name a few. *See, e.g., RJT Invs. X v. Comm'r of Internal Revenue*, 491 F.3d 732, 735–37 (8th Cir. 2007); *Weiner v. United States*, 389 F.3d 152, 154–55 (5th Cir. 2004); *Chimblo v. Comm'r of Internal Revenue*, 177 F.3d 119, 120–21 (2d Cir. 1999); *Olson v. United States*, 172 F.3d 1311, 1316–18 (Fed. Cir. 1999); *Kaplan v. United States*, 133 F.3d 469, 471–72 (7th Cir. 1998); *Keener v. United States*, 76 Fed. Cl. 455, 457–59 (2007).

Plaintiffs' other grounds for its motion for reconsideration are similarly without merit. Plaintiffs' arguments regarding the comprehensive nature of their tax settlement agreements with the government are repeated arguments that have already been raised and fully considered. Pls.' Br. in Support of Resp. in Opp. at 15–20 [Docket #74]. Plaintiffs' arguments referencing *McGann I* are also arguments that have

been previously raised and considered by this Court. Pls.' Post Trial Br. at 16–20 [Docket #85]. And although *McGann II* was issued after the decision in *Prati*, the decision in *McGann II* was based on arguments considered by this Court previously, and thus does not provide anything new. Finally, plaintiffs' various arguments asking the Court to reconsider its decision regarding jurisdiction over tax-motivated interest are also arguments that have been fully briefed and adjudicated. Pls.' Br. in Support of Resp. in Opp. at 7–8, 30–32 [Docket #74]; Def.'s Reply at 3–5 [Docket #78].

In sum, plaintiffs' motion for reconsideration is comprised of arguments already decided by the Court. These arguments are precisely the type that Rule 59 reconsideration must avoid. RCFC 59. It should be stressed that a motion for reconsideration is not a forum in which a losing party may re-argue its case. *Fru-Con Constr. Corp.*, 44 Fed. Cl. at 300. Ultimately, plaintiffs did not identify an intervening change in the controlling law, bring forth new evidence that was shown to be previously unavailable, nor did they show in their motion that reconsideration is necessary to prevent manifest injustice. *See Bishop*, 26 Ct. Cl. at 286. Plaintiffs have failed their burden by not demonstrating any error of law nor mistake of fact. Without such demonstrations, or by showing other similar concerns, the demands of justice, far from favoring plaintiffs, favor the defendant.

In the alternative, as stated, plaintiffs seek to vacate judgment in the 77 cases and stay them pending the outcome of the Federal Circuit's decision in *Keener*,

or to consolidate the remaining 76 cases for appeal. Plaintiffs request the stay "to preserve the resources of all parties and the courts" and to prevent "fundamental unfairness." Pls.' Mot. for Reconsideration, April 30, 2008, at 21 [Docket #89].

"[T]he power to stay proceedings is incidental to the power inherent in every court to control the disposition of the cases on its docket with economy of time and effort for itself, for counsel, and for litigants," and is left to the sound discretion of the trial court. *Landis v. N. American Co.*, 299 U.S. 248, 254 (1936). In determining whether to grant a stay pending the outcome of another case, the court (1) considers whether there is a "pressing need for the stay," and (2) balances the "interests favoring a stay against interests frustrated by the action." *Cherokee Nation of Oklahoma v. United States*, 124 F.3d 1413, 1416 (Fed. Cir. 1997).

In *Cherokee Nation*, the Federal Circuit held that the desire to "avoid duplicative litigation and conserve judicial resources" was insufficient, by itself, to warrant a stay. *Id.* at 1416. Here, the *Prati* cases have been adjudicated and are ripe for review on the jurisdictional issue and, unlike a stay pending an interlocutory or administrative appeal, concerns about resources and judicial economy are not as relevant. Additionally, the balance of the interests weighs against a stay because there is no hardship or inequity to plaintiffs in forcing them to go ahead with their appeals. Moreover, additional AMCOR jurisdictional cases could benefit the Federal Circuit: If the issues are sufficiently similar, the Federal Circuit could

consolidate these *Prati* appeals with *Keener* and reach a single decision with all the relevant cases before the court. Finally, public policy favors "expeditious resolution of litigation." *Kahn v. General Motors Corp.*, 889 F.2d 1078, 1080 (Fed. Cir. 1989). Accordingly, the fact that a companion case is up on appeal is not dispositive of whether the *Prati* cases should be stayed pending its resolution and plaintiffs request is denied.

Finally, plaintiffs request that if the Court will not reconsider or stay the cases, the 76 cases should all be consolidated under *Prati* for purposes of appeal. Plaintiffs make this request under RCFC 42(a), which provides that, "[w]hen actions involving a common question of law or fact are pending before the court, . . . it may order all the actions consolidated . . . ." *See* Pls.' Mot. for Reconsideration, April 30, 2008, at 22 [Docket #89]; *see also d'Abrera v. United States*, 78 Fed. Cl. 51 (2007); *Cienega Gardens v. United States*, 62 Fed. Cl. 28, 33 (2004); *Karuk Tribe of California v. United States*, 27 Fed. Cl. 429, 433 (1993). Because judgment has already been entered in the cases, however, there is no longer any question of law or fact pending before the Court.

Plaintiffs therefore actually request that the Court vacate judgment in the 77 cases, consolidate them under RCFC 42(a), and, finally, re-enter judgment as one consolidated case. All of this so that plaintiffs' appeal may proceed as one case, not 77. As discussed above, plaintiffs do not meet the grounds required by RCFC 59 to vacate judgment. Consequently, the only ground left to plaintiffs is the monetary convenience gained by filing only one appeal. *See* Pls.' Mot. for

Reconsideration, April 30, 2008, at 23 [Docket #89]; Status Conference Tr. at 34, 35; *see also* Fed. Cir. R. 52(a)(3)(A) (setting filing costs at $450 per appeal). Undoubtedly, filing one consolidated appeal is cheaper and quicker than filing 77 individual ones, but administrative convenience is insufficient to justify vacating the judgment under RCFC 59. *See Shirlington Limousine & Transp., Inc. v. United States*, 78 Fed. Cl. 27, 31 (2007).

While plaintiffs cannot seek consolidation once judgment has been entered, plaintiffs are not without a remedy in the Federal Circuit because plaintiffs can seek consolidation for appeal under the Federal Rules of Appellate Procedure, Rule 3. Moreover, if plaintiffs face financial hardships they can also apply to file their appeals *in forma pauperis*. 28 U.S.C. §1915; Fed. Cir. Form 6; *cf. Texaco, Inc. v. Pennzoil Co.*, 784 F.2d 1133, 1145 (2d Cir. 1986) (enforcement of a bond requirement for appeal, the posting of which would have caused appellant to go bankrupt, violated appellant's due process rights), *rev'd on other grounds, Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1 (1987).

C. The Fifteen Individual Motions to Vacate, Plus *Cannon* and *Wyckoff*

Turning to the 15 separate motions to vacate and the *Cannon* and *Wyckoff* cases, as observed, plaintiffs recently discovered, and defendant in part agrees, that at least 15 and as many as 17 cases are not fully covered by *Prati* because they have case-specific claims that are not resolved by the jurisdictional

determinations of the *Prati* opinion.[4] The Court again notes that it was counsel for both parties that advised the Court as to the confluence of the 17 cases with *Prati*. Specifically, on July 17, 2007, the parties jointly filed a chart identifying the various issues alleged in each AMCOR case before the Court. It was the jointly-submitted chart that identified the 77 factually similar cases, and it was the jointly-submitted chart that represented to the Court that the issues in the 17 cases would be conclusively addressed by the *Prati* lead case. Nothing in the jointly-submitted chart indicated to the Court that the 17 cases were factually distinct from the 60 other cases covered by the *Prati* opinion. Had the parties fully explained all the various claims alleged by all the AMCOR plaintiffs as requested by the Court in May 2007, the current confusion regarding the 17 cases would not exist.

Nevertheless, the new information provided to the Court in the motions to vacate and in the May 21 status conference requires the Court to vacate the decisions in at least 15 of the 17 cases for the limited

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[4] The 15 cases in which final judgments will be vacated are: Arumugam, Velusami 4 (02-1395); Barry, Ira (03-200); Belair, Laurence (07-588); Boland, John (06-859); Corkill, Glen (07-147), Dvoranchik, William (07-231); Donaldson, Robert (03-2875); Dykstra, Donald (07-309); Feldman, Merrill (07-224); Fillmore Equipment (07-341); Fournier, E. Haffner (06-933); Martin, Robert (03-2272); Northcutt, Merline (06-860); Cannon, Nassif Jr. (02-61) and Wycoff, E. Lisk Jr. (02-772). Because defendant objects to the motions to vacate in Dhillon, Charanjit (02-1477) and Johnson, Stanley (04-908), the Court will provide plaintiffs' counsel the opportunity to show cause as to why those decisions should be vacated as well.

purpose of permitting plaintiffs to pursue any unresolved case-specific claims that may still exist. The Court is not reconsidering its opinion in *Prati*—the opinion remains the law in each case. However, the new information provided to the Court regarding the 17 cases meets the burden plaintiffs must show in a motion to vacate. *Fru-Con Constr. Corp.*, 44 Fed. Cl. at 301. To deny the motions, given the new information provided to the Court, would be manifestly unjust. *Id.*

III. Conclusion

Having carefully considered plaintiffs' motion for reconsideration, the 15 separate motions to vacate, as well as the parties' multiple representations made during the May 21, 2008 status conference, the Court directs the following:

1) Plaintiffs' May 19, 2008 Motion for Leave to File Reply [Docket #91] is **GRANTED**, and plaintiffs' Reply, filed along with the Motion for Leave, is accepted.

2) Defendant's May 21, 2008 Motion for Leave to File Response [Docket #92] is **GRANTED**, and defendant's Response, filed along with the Motion for Leave, is accepted.

3) The Motion for Reconsideration is **DENIED** in each of the 77 cases covered by the *Prati* opinion.

4) In light of new information provided to the Court by the parties, the judgments in the 15 cases listed in footnote 4 of this Order are **VACATED** for the limited purpose of allowing plaintiffs to pursue any

unresolved, case-specific claims that may still be outstanding.

5) Plaintiffs' counsel is **ORDERED** to show cause by August 4, 2008 why the decisions in *Dhillon* (02-1477) and *Johnson* (04-908) should be vacated.

6) Defendant's counsel is **ORDERED** to respond by August 18, 2008 to plaintiffs' show cause brief. No other briefing with regard to *Dhillon* (02-1477) and *Johnson* (04-908) shall be filed by either party after defendant's August 18 response.

IT IS SO ORDERED.

s/Lawrence J. Block
Lawrence J. Block
Judge

In the
United States Court of Federal Claims

No. 02-60 C
(Filed: April 16, 2008)

RONALD C. & MARY G. PRATI,

Plaintiffs,

v.

THE UNITED STATES OF AMERICA,

Defendant.

Statutory Interpretation; 26 U.S.C. §§6221, 6229, 6231, 6404, 7422; Jurisdiction; TEFRA; Untimely Assessment; Tax-Motivated Transaction; Abatement.

Thomas E. Redding and *Teresa J. Womack*, Redding & Associates P.C., Houston, Texas, for plaintiffs.

Bart D. Jeffries, United States Department of Justice, Tax Division, Washington, D.C., with whom was Assistant Attorney General *Eileen J. O'Connor*, for defendant.

OPINION AND ORDER

Block, *Judge*.

This action is representative of 77 factually-similar, so-called "AMCOR" partnership tax refund cases, which are consolidated for the purposes of the instant motions. These partnerships comprised part of a group

of similarly-structured California limited partnerships that were marketed and managed by American Agri-Corp., Inc. ("AMCOR"). Beginning in 2001, 129 AMCOR tax refund cases were filed in the U.S. Court of Federal Claims, of which 124 were transferred to this judge for administrative convenience and efficiency reasons by request of the parties.[1] Of the 124 cases, 76 present factual allegations virtually identical to the named representative case.[2] In all 77 of these

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[1] Pursuant to Rules of the U.S. Court of Federal Claims ("RCFC") 40.1(b) and (c).

[2] These 77 cases are: Acker, Nadine (07-215); Adams, Samuel (07-162); Arumugam, Velusami (02-1395); Aylward, Thomas (06-593); Baer, Maurice (06-857); Barry, Ira (03-200); Belair, Laurence (07-588); Berman, Robert (06-856); Boland, John (06-859); Brady, Robert (07-315); Caldwell, Bruce (07-548); Cannon, Nassif Jr. (02-61); Casamento, Stephen (06-698); Chapman, Bill (05-1225); Clinton, Tommy (04-116); Connell, Thomas (07-62); Corkill, Glen (07-147); Cox, Dean (04-709); Crocker, Jesse (04-903); Crouse, Betty (07-894); Davidson, Arthur (07-196); Davis, Charles (06-624); Davis, Robert (06-697); Davison, Robert (04-1112); Deegan, Edward (06-594); Dhillon, Charanjit (02-1477); Dvoranchik, William (07-231); Donaldson, Robert (03-2875); Dow, Ruth (06-746); Dykstra, Donald (07-309); Ehrenbard, Robert (03-1559); Fazio, Anthony (07-163); Feldman, Merrill (07-224); Fillmore Equipment (07-341); Fournier, E. Haffner (06-933); Gilbertson, Robert (05-934); Goldman, Elise (04-123); Gregory, Jane (06-578); Hackett, James III (05-758); Hastie, J. Drayton (04-291); Hatton, Richard (04-127); Huguera, Teodoro (07-381); Iannacchino, Michael (06-817); Johnson, Richard (03-2339); Johnson, Stanley (04-908); Jones, Palmer (03-2229); Jones, Thomas Jr. (02-1079); Keefe, Joseph (07-893); Key, Scott (06-293); Lloyd, James (06-623); Ludwig, Gordon (02-1730); Lyons, Edward Jr. (06-391); Lynn, Nancy (07-564); Marshall, Larry (02-474); Martin, Robert (03-2272); Miller,

cases, plaintiffs invested with an AMCOR partnership, claimed a distributive share of a tax deduction from the AMCOR partnership, subsequently had the claimed deductions rejected by the Internal Revenue Service ("IRS"), and then brought suit in this Court for a refund based on the exact same legal grounds that the named plaintiffs in the representative action assert.

In the representative action, plaintiffs Ronald C. Prati and Mary G. Prati ("plaintiffs" or "Pratis") filed the instant action seeking a refund of taxes, interest and penalties paid to the defendant ("United States" or "defendant"). The Pratis are United States citizens who reside in New Smyrna Beach, Florida.[3] The Pratis timely filed their 1985 federal income tax returns and paid the taxes reported due pursuant to that return.

Edward (05-508); Mitchell, Lewis (07-587); Montgomery, William (03-2273); Moody, Robert (06-752); Morris, John (07-405); Northcutt, Merline (06-860); Oehlschlager, Keith (05-1144); Oldshue, Jerry (06-696); Prati, Ronald (02-60); Sadd, William (05-25); Schuler, John (02-432); Sperling, Stanley (02-1523); Strauss, Joseph (06-823); Tanner, Larry (04-1066); Thompson, Richard (06-792); Ungs, Jerome (06-137); Vallari, Stephen (06-761); Vigliotta, John (02-13); Voda, Jan (06-818); Whitaker, Lloyd (02-795); Winternitz, William (01-404); Wyckoff, E. Lisk Jr. (02-772).

[3] Unless otherwise noted, all facts listed are undisputed and are taken from Plaintiffs' Original Complaint, Defendant's 2004 Motion to Dismiss (in Part), Plaintiffs' Motion for Partial Summary Judgment, and Defendant's 2006 Brief in Support of Its Motion for Partial Dismissal.

In 1985, Mr. Prati[4] invested in the Agri-Venture Fund ("AVF"), Canyon Desert Vineyards ("CDV"), and Emperor Seedless-85 ("ES-85") partnerships (collectively "the Partnerships"), and became a limited partner in each. These three Partnerships comprised part of a group of similarly- structured California limited partnerships that were marketed and managed by AMCOR. In the early 1980s, AMCOR organized a number of limited partnerships ("AMCOR Partnerships"), for which it acted as the corporate general partner, and solicited investments from individuals around the country. By 1987, the AMCOR Partnerships had become the subject of an IRS audit and investigation. The IRS alleged that the AMCOR Partnerships, including AVF, CDV and ES-85, were actually illegal tax shelters. Following the IRS investigation of the AMCOR Partnerships, the IRS disallowed the Pratis' 1985 tax deductions attributable to the Partnerships, and assessed additional taxes and penalty interest against the Pratis for 1985.

The Pratis brought suit in this Court on January 22, 2002, seeking a tax refund of $20,523 and a refund of $39,251.35 for interest and penalty interest for a total of $59,774.35. The Pratis primarily allege that defendant's assessment of taxes, interest and penalty was untimely. In the alternative, the Pratis assert two other bases for their refund request: first, they contend that the defendant's charging of penalty interest for substantial underpayment of taxes attributable to a taxmotivated transaction was improper; second, the

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[4] Mary Prati is a party to this proceeding only because she filed a joint tax return with Ronald Prati for 1985.

Pratis argue that the Secretary of the Treasury abused his discretion when he refused to abate the penalty interest accrued against the plaintiffs. Defendant counters that this Court lacks jurisdiction to adjudicate these three claims.

Initially, the AMCOR cases cycled to various judges, following the standard case distribution system employed at the Court of Federal Claims. In October 2002, plaintiffs' attorney and the government filed with the Court a joint notice of indirectly related cases.[5] In the joint notice, attorneys for both parties asserted that there were common issues of fact and law throughout many of the AMCOR cases in front of the Court. Accordingly, the parties proposed to select three cases to serve as representative cases in which dispositive motions could be filed and common issues could be settled.[6]

The Court heard oral arguments on May 1, 2007, to resolve all pending dispositive motions in the three representative cases. At the hearing, the parties requested that the Court initially adjudicate only all the jurisdictional issues found in the AMCOR cases.

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[5] Joint Notice of Indirectly-Related Cases, *Ronald C. Prati and Mary G. Prati v. United States*, (02-60), document #14, filed October 11, 2002. The Joint Notice was also filed in 23 other cases before the Court.

[6] On January 10, 2003, the parties selected *Isler*, *Prati*, and *Scuteri* to serve as the three representative cases for all the AMCOR cases currently on the Court's docket. The parties asked the Court to stay proceedings in all other AMCOR cases until the Court resolved the three representative cases.

Hearing Transcript at 177. On July 17, 2007, the parties jointly filed a chart identifying the various issues alleged in each AMCOR case. The chart revealed that all AMCOR cases fall under two primary categories: (1) Claims for tax years 1984, 1985, or 1986 ("Category 1" claims); and (2) Claims for any tax year other than '84, '85 or '86 ("Category 2" claims).

Within Category 1, there are three types of claims: (1) Untimely assessment ("UA") refund claims for 1984 and 1985 (based on 26 U.S.C. §6229(a)); (2) Tax-motivated interest ("TMI") refund claims for all three years (based on 26 U.S.C. §6221(c)); and (3) interest abatement ("IA") refund claims for all three years (based on 26 U.S.C. §6404(e)(1)). The three types of claims are jurisdictional in nature, and will be explained with greater specificity below.

Within Category 2, there are two types of claims: (1) basis termination ("BT") claims; and (2) income recapture ("IR") claims. The parties refer to this second category of claims as "global claims"—essentially, they are tax refund requests that deal with years other than 1984, 1985, and 1986, and significantly, are not jurisdictional in nature.

The 77 cases in dispute in this opinion, which include *Prati*, are exclusively Category 1 cases, and thus present solely legal or "pure" jurisdictional issues.[7] These jurisdictional issues are presently before

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[7] As to the rest of the cases, the chart revealed that 38 7 of the 124 cases on the docket are exclusively Category 2 cases. These include Anderson, Robert (06-53); Atkinson, Charles (05-1249); Bailey, B. Ralph (06-39); Blinder, Mark (06-52); Chapman, Bill

the Court in the instant case. The parties submitted supplemental briefing in October, 2007. As will be explained, *Prati* and the other Category 1 family of cases should be dismissed for lack of jurisdiction.

I. BACKGROUND

In the early 1980s, AMCOR organized a number of limited partnerships for which it acted as the corporate general partner. The AMCOR Partnerships were agricultural investment entities geared towards high income professionals, and AMCOR solicited investments from such individuals across the country. AMCOR's stated goal was to develop farmland, grow

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(04-1762); Donaldson, Robert (01-386); Durr, William (05-932); Ettelson, Donald (05-1004); Farneti, John Jr. (04-1760); Glasser, Mark (05-1141); Golbuff, Alex (05-1224); Hall, Thomas (05-222); Huebner, Gene (04-1742); Holland, David (06- 405); Horsley, Wilson (04-1766); Hubbell, James (05-565); Johnson, Richard (06-398); Keefe, Joseph (05-1402); Kirwan, Martin (05-489); Kraemer, Kenneth (04-1761); Lyon, Donald (04-1324); Malouf, Scott (04-1744); Marks, Paul (04-1763); Martin, Robert (05-1251); McDaniel, George (04- 1788); McGann, Thomas (06-430); Meunier, Gerald (05-880); Morris, John (05-933); Penni, Jonathan (04-1161); Rossman, Neil (07-346); Rutherford, H. Doug (04-1767); Sardinas, Alfredo (05- 1250); Scuteri, Jeffrey (04-1160); Steffansson, Sturla (06-399); Ungs, Jerome (04-1764); Weiner, Morris (01-623); Whittington, G. Dale (05-220); Wong, William (06-404). Eight cases make both Category 1 and Category 2 claims, including *Isler* and *Scuteri*, the other two representative cases. They are: Bolen, Richard (02-696); Isler, Robert (01-344); Lewis, David (02-1080); Mastropieri, Carmen (02-910); McMenamin, Hugh (04-1745); Pineo, Helen (02-401); Prendergast, James (04- 1819); Scuteri, Jeffrey (01-358). One case, Penni, Samuel (04-1818), presents neither Category 1 nor Category 2 claims, and instead presents individual estate tax claims.

fruit crops such as dates, and other crops such as wheat, corn and alfalfa. Appendix B to Pls.' Response to Def.'s Motion to Dismiss, Tab 6. By 1987, the AMCOR Partnerships had become the subject of an IRS audit and investigation. The IRS alleged that the AMCOR Partnerships, including AVF, CDV and ES-85, were actually illegal tax shelters.

Within six years of its founding, AMCOR had raised a total of $206 million from 3,000 investors who put up cash and notes to pay farmers to grow crops. Investors paid for all the farming expenses up front and deducted that amount invested on their tax returns. Most investors saved as much in taxes as they invested, or even more. For example, an investor who put down $25,000 in cash and signed a $50,000 note could deduct the entire $75,000 from his tax return. At an income tax rate of 50 percent, the maximum at the time, the investor's tax bill would be cut by $37,500. The next year, when the crops were harvested, all proceeds would have been subject to taxes. However, the expense of the agricultural enterprises always exceeded any income realized from the farming activities. Further, the investors could spread out reporting the proceeds from their investments over ten years. The proceeds could also then be invested through AMCOR into other farming operations, where the money was further sheltered. In effect, by participating in an AMCOR Partnership, an investor could obtain what amounted to an interest-free loan from the government for the unpaid portion of his taxes.

In 1985, Mr. Prati invested $30,000, $45,000, and $30,000 in AVF, CDV, and ES-85, respectively, and became a limited partner in each. The Partnerships were all AMCOR Partnerships, marketed and managed by AMCOR. The stated goal of the Partnerships was to acquire agricultural land, invest in agricultural ventures, and grow crops. Pursuant to AVF's partnership agreement, its general partners were Frederick H. Behrens, CPA, Chairman and a director of AMCOR; George L. Schreiber, President and a director of AMCOR; and Robert A. Wright, Vice President and a director of AMCOR. CDV and ES-85's partnership agreements were structured similarly to the AVF partnership.

The Partnerships timely filed their partnership returns for 1985. Each of the Partnerships reported an ordinary loss for 1985, of which Mr. Prati was allocated a share that he claimed in his personal tax return. The Pratis reported taxable income of $108,845 in 1985. The Pratis recognized and reported the following shares of the Partnership losses in their 1985 tax return: $89,290 from AVF, $94,893 from CDV, and $66,120 from ES-85, for a total deduction of $250,303.

Following the IRS investigation of the AMCOR partnerships, the IRS issued a notice of final partnership administrative adjustment ("FPAA") to each of the three Partnerships on April 10, 1991, adjusting the amount of deductions the Partnerships claimed in their 1985 tax filings. A notice of FPAA, as will be discussed in more detail below, is the method by which the IRS notifies a partner that the IRS is

adjusting an item in that partnership's tax filing.[8] 26 U.S.C. §6223. On July 10, 1991, a notice partner[9] for each of the Partnerships filed a petition for readjustment on behalf of each of the Partnerships in the United States Tax Court. In 1999, Fredrick Behrens, the tax matters partner ("TMP") for each of the Partnerships, filed a notice of election to intervene in each of the Partnerships' readjustment petitions.[10] The Pratis did not file an election to intervene in the readjustment petitions.

On March 25, 1997, the Pratis executed three Forms 870-P(AD), Settlement Agreement for Partnership Adjustments, in which they offered to settle their income tax liability for 1985, as it related to Mr. Prati's investment in AVF, CDV, and ES-85.[11] The IRS accepted the offers by countersigning the Forms 870-P(AD) for CDV and ES-85 on April 21, 1997, and for AVF on April 24, 1997. In June of 1997, the IRS informed the Pratis how the agreed-upon adjustments would affect the Pratis' 1985 tax return.

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[8] Of course, as will be discussed below, partnerships do not pay taxes. 26 U.S.C. §701.

[9] A "notice partner" is a partner who, at the time in question, would be entitled to notice from the government that an adjustment was being made to the tax filing. 26 U.S.C. §6223(a).

[10] The TMP is a person or entity designated as such by the partnership under applicable regulations, or most commonly, the general partner with the largest profit stake in the partnership. 26 U.S.C. §6231(a)(7).

[11] A "Form 870-P(AD)" is simply a settlement agreement form used by the IRS.

The IRS stated that adjustments of $33,369, $42,921, and $26,326 (for AVF, DCV, and ES-85, respectively) would be disallowed from the Pratis' taxable income as originally reported on their 1985 tax return, and how, as a result, the Pratis would owe additional tax of $20,523, due to these adjustments.

On October 10, 1997, the Pratis made an advance payment of $63,875 to the IRS for the Pratis' 1985 tax account. On October 20, 1997, the IRS assessed tax and penalty interest against the Pratis for 1985 in the respective amounts of $20,523 and $39,251.35. The IRS then refunded the Pratis $4,100.65, the amount overpaid by the Pratis in their October 10, 1997 advance payment.

On April 16, 1999, the Pratis filed a claim with the IRS for the refund of the additional income tax and penalty interest amounts of $20,523 and $39,251.35. In two letters, dated January 19, 2000 and February 7, 2000, the IRS informed the Pratis that their claims had been denied.

II. DISCUSSION

A. The Tax Equity and Fiscal Responsibility Act of 1982.

Before turning to the parties' contentions, it is helpful to first address the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), the statutory labyrinth in which the parties find themselves. Although noted as "distressingly complex and confusing," see *Rhone-Poulenc Surfactants and Specialties, L.P. v. Comm'r of Internal Revenue*, 114 T.C. 533, 540 (2000), TEFRA originally was enacted to

simplify and streamline the procedures by which partnerships are examined for federal taxation purposes.

As mentioned above, a partnership is not a taxable entity. Instead, a partnership is treated as a conduit through which income passes to its partners, who are then responsible for reporting any income or losses on their individual returns. Partnerships neither incur tax liability, nor do they pay taxes. All taxable events to which a partnership is a party generate tax consequences for its partners, generally to the extent of the partner's interest in the partnership. *See generally* KAREN C. BURKE, FEDERAL INCOME TAXATION OF PARTNERS AND PARTNERSHIPS IN A NUTSHELL (3d ed. 2005).

Prior to TEFRA's enactment, the examination of a partnership for federal tax purposes was an exceedingly tedious process. As with partnerships today, pre-TEFRA partnerships filed informational tax returns, known as Form 1065s. A Form 1065 reflects the distributive share of income, deductions, and credits attributable to each partner. Each partner then filed his own tax return, reflecting his distributive share of the partnership's gains and losses. However, if the IRS deemed it necessary to adjust an item listed on a Form 1065, the IRS was essentially forced to audit each individual partner in a partnership. As a consequence, the IRS could not guarantee consistent treatment of a partnership item for each partner in a partnership.

To remedy this concern, Congress enacted TEFRA. TEFRA "created a single unified procedure for

determining the tax treatment of all partnership items as the partnership level, rather than separately at the partner level." *In re Crowell*, 305 F.3d 474, 478 (6th Cir. 2002) (citing H.R. CONF. REP. NO. 97-760, at 599–600 (1982) ("The tax treatment of items of partnership income, loss, deductions, and credits will be determined at the partnership level in a unified partnership proceeding rather than in separate proceedings with the partners. . . . The tax treatment of any partnership item is to be determined at the partnership level.")). The creation of this "partnership level" proceeding meant that, after TEFRA's enactment, if the IRS wished to adjust items (*e.g.*, deductions for business losses included on a Partnership's Form 1065) it could do so at a singular proceeding, and then subsequently assess all of the partners based upon the adjustment to that particular item. The IRS would not have to conduct individual "partner level" proceedings for each member of a partnership.

Whether TEFRA procedures apply depends on the threshold determination of whether or not an item is a "partnership item." Section 6231 of the tax code provides, in relevant part:

> The term 'partnership item' means, with respect to a partnership item, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provided that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

26 U.S.C. §6231(a)(3). Which items are "more appropriately determined at the partnership level" is refined in Treasury Regulation §301.6231(a)(3)-1, which provides that such items include the income, gains, losses, deductions and credits of a partnership. 26 C.F.R. §301.6231(a)(3)-1. *See also Prochorenko v. United States*, 243 F.3d 1359, 1363 (Fed. Cir. 2001); *Keener v. United States*, 76 Fed. Cl. 455, 458 (2007). Significant to this case, a partnership item is defined by the treasury regulations to also include factors that *affect* the determination of partnership items.

> The term "partnership item" includes the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc.

26 C.F.R. §301.6231(b).

Nonpartnership items are items that are not treated as partnership items, 26 U.S.C. §6231(a)(4), and the tax treatment of nonpartnership items is determined at the individual partner level. *See Crnkovich v. United States*, 202 F.3d 1325, 1328–29 (Fed. Cir. 2000); *Keener*, 76 Fed. Cl. at 458. There exists a third category of TEFRA items—"affected items"—which are defined as "any item to the extent such item is affected by a partnership item." 26 U.S.C. §6231(a)(5).

A penalty assessed against a partner based on the partner's tax treatment of partnership items on his individual return is an example of an "affected item." *See Olson v. United States*, 172 F.3d 1311, 1316–17 (Fed. Cir. 1999); *Keener*, 76 Fed. Cl. at 458 n.4. If the

IRS decides to adjust the tax treatment of any partnership item reflected on the partnership's informational tax return, TEFRA requires the IRS to notify the individual partners through a notice of FPAA.[12] 26 U.S.C. §6223.

There are several timeliness considerations. The general statute of limitations for individual taxpayers is §6501(a), which requires that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed." 26 U.S.C. §6501(a). Before TEFRA, the IRS could not assess a partner based upon a partnership item adjustment if *more than three years had elapsed from the filing of the partner's personal return*; the filing date of the partnership's Form 1065 was for the most part irrelevant. *See* H.R. CONF. REP. No. 97-760 at 599.

With the enactment of TEFRA, the IRS was given a "buffer," 26 U.S.C. §6229(a), to the normal assessment period. Section 6229(a) provides:

> Except as otherwise provided in this section, the period for *assessing* any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the *later* of–

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[12] A FPAA is the actual adjustment to the partnership item in question. A notice of FPAA is simply the way by which the IRS notifies a partner of the fact that the IRS is adjusting an item in that partnership's tax filing. 26 U.S.C. §6223.

> (1) the date on which the partnership return for such taxable year was filed, or
>
> (2) the last day for filing such return for such year (determined without regard to extensions).

26 U.S.C. §6229(a) (emphasis added). Although not strictly speaking a "statute of limitations," *see Andantech LLC v. Comm'r*, 331 F.3d 972, 977 (D.C. Cir. 2003), §6229(a) allows the IRS to assess partners individually based upon adjustments to partnership items made in an FPAA, so long as the assessment is made within three years of the partnership return's filing.[13] *See AD Global Fund, LLC ex rel. North Hills Holding, Inc. v. United States*, 481 F.3d 1351, 1352 (Fed. Cir. 2007) (observing that "[section] 6229(a) does not provide a separate statute of limitations, but simply creates a minimum period that may extend the regular statute of limitations for partnership items").

Significantly, if the FPAA is issued during that window, the assessment need not be made within the same three-year period. It should be noted that it is incorrect to speak of an FPAA as being *untimely*—an FPAA can never be untimely, *i.e.*, a partner cannot object to the issuance of an FPAA or the adjustment of partnership items contained within the FPAA based solely upon the date an FPAA was issued. Timeliness

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[13] The three-year period in which to issue a FPAA can by extended by agreement between the IRS and an individual partner (which binds only that partner to that agreement), or by agreement between the IRS and the partnership's TMP (which binds all partners to such an agreement). 26 U.S.C. §6229(b).

is at issue only to determine the legality of an *assessment* that is based upon *adjustments* to partnership items.

Following the issuance of a FPAA, the TMP initially has the exclusive right to file a petition for readjustment of the partnership items in the Tax Court, the Court of Federal Claims, or a United States District Court. 26 U.S.C. §6226(a). The purpose of a petition is to contest the substantive changes that the IRS has made in the FPAA. If the TMP does not petition for readjustment, other partners have 60 days to file a petition for readjustment of the partnership items. 26 U.S.C. §6226(b)(1). The court before which a petition for readjustment is brought has jurisdiction to "determine all partnership items of the partnership for the partnership taxable year." 26 U.S.C. §6226(f). This jurisdiction includes the power to make the "proper allocation of [partnership items] among the partners, and [to determine] the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item." *Id.* Hence, the court hearing the petition must determine the proper quantification, qualification and characterization of tax items, such as income, losses, deductions, credits and the like. Upon the conclusion of the partnership level proceedings, within one year, the IRS may assess additional tax liabilities, penalties and interest against individual partners based upon the partnership item adjustments. 26 U.S.C. §6229(d).

In theory, a partner may contest the tax liability by paying the assessment and filing a refund action in the U.S. Court of Federal Claims. 26 U.S.C. §6226(e).

Nevertheless, and significantly, §7422(h) of TEFRA limits a partner's ability to seek a refund based on adjustments made to the partnership's return by depriving all courts of jurisdiction to hear partner refund claims where the refund is "attributable to partnership items (as defined in section 6231(a)(3))." 26 U.S.C. §7422(h).

Alternatively, a partner may choose to settle his individual tax liability with the IRS. 26 U.S.C. §6224. If a partner would so choose, that partner would no longer participate in the partnership level proceeding, and instead would be bound by the terms of his settlement agreement. *Id.* Additionally, any of that settling individual's partnership items would convert to nonpartnership items. 26 U.S.C. §6231(b)(1)(c). Partnership items convert to nonpartnership items when the IRS enters into a settlement agreement with the partner with respect to such items. *Id.* If a partner files an action for a refund attributable to partnership items, but those items have been converted through a settlement agreement, the jurisdictional bar of §7422(h) no longer applies. *See Alexander v. United States*, 44 F.3d 328, 331 (5th Cir. 1995).

Having briefly explained the TEFRA format, the Court is now able to address the parties' various jurisdictional contentions.[14]

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[14] In addition to the jurisdictional contentions, it should be noted that the parties spent a large portion of their briefs arguing over the applicability of the doctrine of *res judicata*. Govt.'s Motion to Dismiss in Part at 28; Pls.' Response to Govt.'s Motion to Dismiss at 22. Specifically, the government contends that even if the Court does have jurisdiction over the Pratis' various claims, the Court is

B. Was the IRS Assessment Untimely?

The Pratis' refund claim is based on the theory that their individual statutes of limitations on assessments had run prior to the time the IRS assessed income taxes and interest against them in 1997. Simply stated, the Pratis contend that because the assessment of additional taxes was made more than three years after the partnership filed its return, the assessment was untimely under §6229(a) and should be refunded to the Pratis. Complaint ¶ 12. Further, the Pratis *sua sponte* raise a defensive contention (*i.e.*, they did not make this argument in response to a contention by the government) that because the Form 870-P(AD) settlements they entered into were executed after the §6229(a) limitations period had expired, they did not waive the statute of limitations. *Id.* It is uncontroverted that the Pratis did not intervene in the partnership level proceeding, and therefore did not raise the issue of timely assessments at the Tax Court. Ex. 14, App. B of Govt.'s Motion to Dismiss in Part.

In response, defendant contends that the limitations-period challenge is a partnership-level defense prohibited by the jurisdictional bar of 26

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barred from hearing the Pratis' claims because the Pratis could have participated in the partnership-level proceedings of their partnerships. Govt.'s Motion to Dismiss in Part at 28. Predictably, the Pratis argue that their claims are not barred by *res judicata*, because their challenges are not partnership items that would be addressed at a partnership-level hearing. Pls.' Response to Govt.'s Motion to Dismiss at 22. Nevertheless, because the Court finds the jurisdictional issues to be dispositive, it need not address the *res judicata* arguments.

U.S.C. §7422(h). According to the government, whether §6229(a) extended individual limitations periods on assessments found in §6501 of the Code is a "partnership item" issue that should have been raised at the Tax Court and cannot be raised here. Govt.'s Motion to Dismiss in Part at 20. Defendant argues that if the Court were to determine the timeliness of the assessment, such a determination would affect the assessment for all partners in the Partnerships and would therefore be a partnership-level determination which is barred by §7422(h). *Id.* at 26.

To avoid the jurisdictional bar of §7422(h), plaintiffs assert that the determination of a limitations period does not constitute a partnership item because the provision at issue, §6629(a) of the Internal Revenue Code, lies in subtitle F of the Tax Code, and not in subtitle A.[15] Pls' Response to Govt.'s Motion to Dismiss in Part at 9. This is based on plaintiffs' reading of §6231(a)(3) whereby the definition of a partnership item ("any item required to be taken into account for the partnership's taxable year *under any provision of subtitle A*" (emphasis added)) means only such items found in subtitle A. *Id.* According to plaintiffs, because the relevant procedural limitations provisions, §§6229(a) and 6501 of the Tax Code, are found in

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[15] Subtitle A of the Internal Revenue Code is entitled "Income Taxes." Subtitle A contains subchapter K, "Partners and Partnerships," which contains requirements for the tax liability of partners. Subtitle F of the Internal Revenue Code is entitled "Procedure and Administration." Subtitle F contains subchapter C, "Tax Treatment of Partnership Items," which contains rules relating to the treatment of partnership items, including 26 U.S.C. §§6221, 6229, and 6231.

subtitle F of title 26, a time limitation cannot by definition be considered a partnership item. *Id.*

But this is a strained interpretation. Statutory interpretation must begin with the language of the statute, *Lamie v. United States Trustees*, 540 U.S. 526, 534 (2004); *Electrolux Holdings, Inc. v. United States*, 491 F.3d 1327, 1330 (Fed. Cir. 2007), and its plain meaning from its text, structure, and purpose, *U.S. Nat'l Bank of Oregon v. Independent Ins. Agents of America Inc.*, 508 U.S. 439, 455 (1993) (commenting that "in expounding a statute, [the Court] must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy"); *Terry v. Principi*, 340 F.3d 1378, 1385 (Fed. Cir. 2003) (explaining that "when we construe a statute, we do so in the setting of the statutory scheme of which it is a part"); *see also Electrolux Holdings*, 491 F.3d at 1330 (citing *Norfolk Dredging Co. v. United States*, 375 F.3d 1106, 1110 (Fed. Cir. 2004)).

Application of these common sense strictures reveals that a more reasonable alternative to plaintiffs' interpretation is to view the requirement of "*under any provision of subtitle A*" as modifying not "any [partnership] item" (which, again, is itself defined in subtitle F, not subtitle A) but what immediately precedes it in the clause, which is "the partnership's taxable year." *See* WILLIAM STRUNK JR. & E.B. WHITE, THE ELEMENTS OF STYLE 4–5, 59 (4th ed. 1999) (pointing out the rule of grammar that a restrictive clause limits or defines what immediately precedes it and is not set-off by a comma). This makes eminent

sense because while subtitle A encompasses substantive rules for a partner's income tax, subtitle A's provisions make clear that this income is derived from the partnership during the partnership's taxable year, as defined by this subtitle. *See River City Ranches #1 Ltd., v. Comm'r of Internal Revenue*, 401 F.3d 1136, 1144 (9th Cir. 2005) (recognizing that because subtitle F provisions administer subtitle A requirements, partnership's tax items affected by subtitle F provisions are litigated in partnership proceedings, not in the partner's). But ultimately, it is the reasonableness of the interpretation that controls. *See Warner-Lambert Co. v. Apotex Corp.*, 316 F.3d 1348, 1355 (Fed. Cir. 2003) (remarking that when "interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but will take [it] in connection with . . . the whole statute"); *see also Sandberg v. McDonald*, 248 U.S. 185, 204 (1918) (observing that the common law canon "*reddendo singula singulis*[16] . . . . [requires that] words and provisions . . . [relate] to their appropriate objects . . . [thus] resolving confusion and accomplishing the intent of the law against, it may be, a strict

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[16] Indeed, the canon *reddendo singula singulis* requires that when a statutory provision contains several antecedent phrases that could modify various other phrases thus supplying differing meanings, the one chosen should be the one most properly related by context and applicability. *See, e.g., Go-Video, Inc. v. Akai Elec. Co., Ltd.*, 885 F.2d 1406, 1412 (9th Cir. 1989) (citing SUTHERLAND STAT. CONSTR. §47:26 to support the application of *reddendo singula singulis*, "interpret[ing] a passage in which antecedents and consequents are unclear by reference to the context and purpose of the statute as a whole"). *See generally* SUTHERLAND STAT. CONSTR. §47:26.

grammatical construction"). *See generally* 2A NORMAN J. SINGER, SUTHERLAND STAT. CONSTR. §46:5 (7th ed. 2007) (and cases cited therein) [hereinafter SUTHERLAND STAT. CONSTR.] (noting that words are to be applied to the subjects that seem most properly related by context and applicability pursuant to the canon *reddendo singula singulis*).

The import of this is that "*any item*" ("required to be taken into account for the partnership's taxable year") necessarily must be given a more expansive interpretation than plaintiffs' interpretation would.[17] Thus, in context, it means *anything* that would *affect* (in plain English, "influence"[18]) the partnership's taxable year, the application of the word "affect" being equivalent here to the provision's phrase "*required to be taken into account*" for the "partnership's taxable year."[19] All of this is merely another way of expressing

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[17] This principle has long been recognized in constitutional law. Most famous is *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), upholding the legality of the first National Bank by construing the Necessary and Proper Clause, U.S. CONST. art. I, §8, cl. 18, as delegating to Congress broad "implied" power to effectuate the enumerated Article I powers.

[18] "Affect" is defined as "(1) to act upon: to produce an effect (as of disease) upon, to produce a material influence upon or alteration" or "(2) to have a detrimental influence on—used especially in the phrase affecting commerce, to INFLUENCE." MERRIAM-WEBSTER UNABRIDGED DICTIONARY, http://unabridged.merriam-webster.com/cgi-bin/

[19] This is implicit in the reasoning of *Slovacek v. United States*, 36 Fed. Cl. 250, 255 (1996), whereby whether the period of assessment has been extended by TEFRA and therefore a

the axiom that in construing statutes, courts may determine appropriate meaning by considering the policy behind a law's enactment. *See, e.g., Holloway v. United States*, 526 U.S. 1, 9 (1999) (noting that "statutory language should be interpreted consonant with 'the provisions of the whole law, and . . . its object and policy'"); *Star- Glo Assocs., LP v. United States*, 414 F.3d 1349, 1357 (Fed. Cir. 2005) (considering the purpose of a statute to determine the meaning of an ambiguous term in the statutory text). This is particularly so when construing tax and revenue measures due to the importance of policy in avoiding a literal woodenness creating unworkable or absurd results. *See Coltec Industries, Inc. v. United States*, 454 F.3d 1340, 1354 (Fed. Cir. 2006) (construing "economic substance test" in light of policy underlying tax code, "the economic substance doctrine is not unlike other canons of construction that are employed in circumstances where the literal terms of a statute can undermine the ultimate purpose of the statute"); *see also United States v. Native Village of Unalakleet*, 411 F.2d 1255, 1258 (Ct. Cl. 1969) (observing that, at times, a court may "construe the statute contrary to its 'plain language' if a literal interpretation makes a discrimination for which no rational ground can be suggested.").

To be sure, the Court's reading permits treating, as partnership items, any and all legal issues that influence the treatment of partnership items arising

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partnership item is equated to whether it "affects" the "amount, timing and characterization" of partnership items "in thumbs-up or thumbs-down manner."

under subtitle A. This construction is in accord with the purpose of TEFRA: "a statutory scheme that intends that adjustment to a partnership tax return be completed in one consistent proceeding before individual partners are assessed for partnership items." *AD Global*, 481 F.3d at 1355 (internal citations omitted); see In re Crowell, 305 F.3d at 478 (citing H.R. CONF. REP. No. 97-760, at 599–600 (1982)); *see also Kokoszka v. Belford*, 417 U.S. 642, 650 (1974) (opining that particular statutory provisions must be interpreted in connection with the whole statute "and the objects and policy of the law, as indicated by its various provisions"). Indeed, even if one accepts plaintiffs' interpretation, nothing would prevent a court from looking outside subtitle A to effectuate §6231(a)(3). *See River City Ranches # 1 Ltd.*, 401 F.3d at 1144 (holding that the assessment provisions in subtitle F may be considered partnership items); *Clark v. United States*, 68 F. Supp. 2d 1333, 1345 (N.D. Ga. 1999) (same); *see also Kaplan*, 133 F.3d at 473 (subtitle F provisions involving authority of TMP may be considered partnership item); *Klein v. United States*, 86 F. Supp. 2d 690, 696 (E.D. Mich. 1999) (same). Furthermore, tax treatment uniformity is furthered because if the TMP does not raise the timeliness issue, a partner could certainly intervene at the appropriate proceeding. 26 U.S.C. §6226(c)(2).

This interpretation is consistent with, even buttressed by, the application of the separate, yet related, technical statutory definition of an "affected item" (defined by 26 U.S.C. §6231(a)(5) as any "item to the extent such item is affected by a partnership item"), addressed by the court in *Keener*, 76 Fed. Cl. at

460–61. There, as here, the court faced the argument that because the assessment periods under section 6501 are unique to each partner, the assessment periods are "affected items" under §6231(a)(5)) and thus the Tax Court could not have reached a determination concerning the partner in the partnership-level proceeding. *Id.*; *see* TREAS. REG. §301.6231(a)(5)-1(a).

Although there is not unanimity of analysis, most courts have concluded that there are two types of affected items. The first is a computational adjustment "made to reflect change in a partner's tax liability resulting from partnership-level adjustments." *Korchak v. Comm'r of Internal Revenue*, 90 T.C.M. (CCH) 403 at *20 (2005) (citing *N.C.F. Energy Partners v. Comm'r of Internal Revenue*, 89 T.C. 741, 744 (1987)). The second requires a determination that must be made at a partnership level. *Id.* The *Keener* court explained that because the tax treatment of an "affected item" usually depends upon the partnership-level determination, "affected items generally cannot be tried as part of a partner's tax case prior to the completion of the partnership-level proceeding." *Keener*, 76 Fed. Cl. at 460–66 (citing *GAF Corp. & Subs. v. Comm'r of Internal Revenue*, 114 T.C. 519, 528 (2000) (quoting *Gillilan v. Comm'r of Internal Revenue*, 66 T.C.M. (CCH) 398, 401 (1993))); *see also Katz v. Comm'r of Internal Revenue*, 335 F.3d 1121, 1124 (10th Cir. 2003); *Clark*, 68 F. Supp. 2d at 1347. *But see Field v. United States*, 328 F.2d 58, 60 (2d Cir. 2003) (holding that §6621(c) interest is not an "affected item" because it "turns on matters that are specific to individual partners"). *See generally* ARTHUR B. WILLIS,

JOHN S. PENNELL & PHILIP F. POSTLEWAITE, PARTNERSHIP TAXATION [HEREINAFTER "PENNELL"] ¶ 20.02[4][c] (6th ed. 1999) (and cases cited therein).

Accordingly, partners must first raise any partnership item that "affects" their personal items at the unified partnership-level proceeding. Here, the proper construction of §6229(a), as explained above, certainly falls into that category. The result from the partnership-level proceeding is then applied at the individual partner level "to the extent that it impacts what otherwise is a nonpartnership item-in this case, the limitations period on assessments." *Keener*, 76 Fed. Cl. at 460. In other words, partners "must first raise any partnership item that 'affects' their personal items at the partnership-level proceeding" and "obtain resolution of the partnership prong of their affected items before later turning to the affected nonpartnership prong." *Id.* at 461. This the Pratis did not do.[20]

To be sure, whether categorized as a "partnership item" or as an "affected item," the Court is without jurisdiction to adjudicate the statute of limitations issue plaintiffs raise in this partner-level proceeding. This is because any resulting refund here would be "attributable to" partnership items within the meaning of §7422(h), *see Braunstein v. Comm'r of Internal*

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[20] And, as the *Keener* court points out, it is worth repeating that even if the TMP fails to raise the issue, "section 6226(c) of the Code entitles a partner to participate fully as a party in the partnership proceeding, presumably allowing such a partner to raise [such] issues." *Id.* (citing *Clark v. United States*, 68 F. Supp.2d at 1345–46 (discussing this provision)).

Revenue, 374 U.S. 65, 70 (1963) ("attributable" defined as "caused or generated by"); *Gilman v. Comm'r of Internal Revenue*, 933 F.2d 143, 151 (2d Cir. 1991) ("attributable" means "stems from"); *Keener*, 76 Fed. Cl. at 461–62, or are partnership items that influence affected items, such as partnership items falling within the partnership prong of an affected item, *see Katz v. Comm'r of Internal Revenue*, 335 F.3d 1121, 1124 (10th Cir. 2003); *Clark*, 68 F. Supp. 2d at 1347.

What is more, the relevant Treasury Regulation defining a "partnership item" as including "the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit gain, loss, deduction, etc.," Treas. Reg. §301.6231(a)(3)-1(b), reflects this Court's approach. And although a court has a duty to independently interpret the relevant statutory provisions and their construction or application to the case at bar—*Chevron U.S.A. Inc. v. Nat'l Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984) ("[i]f the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress"); *see also Electrolux Holdings, Inc.*, 491 F.3d 1327—in the realm of tax law, some nod to judicial deference to the IRS's interpretation of its own rules and regulations is recognized. *See Welch v. Helvering*, 290 U.S. 111 (1933) (stating that determinations of the IRS commissioner are presumptively correct). This notice of disallowance is consequentialist in nature, looking at pragmatic results that apply a reasonableness standard both in interpretation and application, the latter usually

encompassing how the agency interpretation affects statutory language, structure, and mandates.

A good and simple example is *United States v. Correll*, 389 U.S. 299 (1967). Correll, a traveling salesman, brought suit for a refund of taxes paid. Customarily leaving home early each morning, but eating breakfast and lunch on the road and returning home at night for dinner, Correll had deducted the cost of his morning and noon meals as "traveling expenses" incurred in the pursuit of his business "while away from home" under §162(a)(2) of the tax code of 1954. *Id.* at 300. Nevertheless, the Commissioner disallowed the deductions, ruling unless the daily trips required sleep or rest (which they did not) the cost of the meals was a "personal living" expense. *Id.* In upholding the Commissioner's interpretation of the relevant statutory provisions, the Supreme Court noted that the role of the judiciary "begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner." *Id.* at 307. While conceding that alternative interpretations to the Commissioner's "sleep or rest" rule could be crafted, the Court noted that in reviewing tax law, courts should not "sit as a committee of revision to perfect the administration of tax laws." *Id.* at 306–07.[21] This approach has been

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[21] This is because "Congress has delegated to the Commissioner, not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code . . . it is the province of Congress and the Commissioner to make the appropriate adjustments." *Correll*, 389 U.S. at 307 (internal citations omitted).

followed post-*Chevron*. *See, e.g., United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 219 (2001) (the judiciary should "defer to the Commissioner's regulations as long as they 'implement the congressional mandate in some reasonable manner'") (quoting *United States v. Correll*, 389 U.S. 299, 307 (1967)); *Hospital Corp. of America & Subsidiaries v. Comm'r of Internal Revenue*, 348 F.3d 136, 141 (6th Cir. 2003); *Grapevine Imports, Ltd. v. United States*, 71 Fed. Cl. 324, 336 (2006).

Furthermore, it is also worth noting that other courts addressing similar challenges have rejected plaintiffs' position. *See, e.g., Weiner v. United States*, 389 F.3d 152 (5th Cir. 2004); *Chimblo v. Comm'r*, 177 F.3d 119 (2d Cir. 1999); *Kaplan v. United States*, 133 F.3d 469 (7th Cir. 1998); *Williams v. United States*, 165 F.3d 30 (6th Cir. 1998) (unpublished table decision); *Barnes v. United States*, 1997 WL 732594 at *3 (M.D. Fla. July 25, 1997), *aff'd*, 158 F.3d 587 (11th Cir. 1998); *Thomas v. United States*, 967 F. Supp. 505 (N.D. Ga. 1997); *Slovacek v. United States*, 36 Fed. Cl. 250 (1996); cf. *RJT Investments X v Comm'r of Internal Revenue*, 491 F.3d 732, 736–38 (8th Cir. 2007) (holding that the determination of the validity of a partnership is more appropriately determined at partnership level); *Hirshfield v United States*, 2001 WL 579783 (S.D.N.Y. 2001) (holding that a challenge to a TMP's authority to act on behalf of the partners is a partnership level challenge), *aff'd*, 70 Fed. Appx. 609 (2d Cir. 2003); *Klein v. United States*, 86 F. Supp. 2d 690 (E.D. Mich. 1999) (same). Indeed, this Court, most recently, in *Keener*, 76 Fed. at 460, characterized plaintiffs' arguments as "well-rehearsed" but "faulty."

The first case dealing with this issue was *Slovacek v. United States*, 36 Fed. Cl. 250 (1996). The plaintiffs in *Slovacek*, like the Pratis here, sought a refund of taxes they paid pursuant to a settlement agreement with the IRS, claiming the taxes assessed against them were assessed after the expiration of a period of limitations. *Id.* at 254. The government there similarly argued that the plaintiffs' claims were barred by §7422(h), and the plaintiffs countered with the argument that their claim was not a partnership item. The court in *Slovacek* reasoned that because the statute of limitations could "affect" the amount, timing and characterization of income, etc., at the partnership level, the challenge must be litigated at the partnership level proceeding. *Id.* at 255.

In *Chimblo v. Comm'r*, 177 F.3d 119, the Second Circuit also addressed this issue, with similar results. The plaintiffs in *Chimblo*, like the Pratis, were members of a partnership who had their deductions attributable to the partnership disallowed by the IRS. Like the Pratis, these plaintiffs did not intervene in the partnership-level tax proceedings, and only after settling their case with the IRS, did they challenge the timeliness of their assessment. The Second Circuit stated that "[a]llowing individual taxpayers to raise a statute of limitations defense in the multiple partner-level proceedings would undermine TEFRA's dual goals of centralizing the treatment of partnership items and ensuring the equal treatment of partners." *Id.* at 125. Accordingly, in applying the policy behind TEFRA, the Second Circuit held that the plaintiffs were barred from raising their statute of limitations defense in a partner-level proceeding. *Id.*

A similar untimely-assessment argument was also addressed by the Seventh Circuit in *Kaplan v. United States*, 133 F.3d 469 (7th Cir. 1998). The Kaplans, like the Pratis, were members of a partnership who claimed their distributive share of partnership loss deductions in their personal tax returns. Eleven years after the tax year in question, the Kaplans were notified by the IRS that some of their partnership deductions were disallowed, and that they owed penalties and interest on their overdue taxes. Unlike the Pratis, the Kaplans claimed they never received notice of the partnership's FPAA, and as a result, they should not owe any penalty or interest on any tax deductions disallowed. Without the Kaplans' knowledge, the partnership's TMP had executed time period extensions with the IRS. The Kaplans challenged the validity of their TMP's authority to act as the TMP for the partnership. They further argued that if the TMP lacked authority to execute the extensions, then the statute of limitations had run on their assessment, and they were not liable for any taxes disallowed. *Id.* at 473.

However, the Seventh Circuit was not swayed by the Kaplans' arguments. If the Kaplans were to succeed with their claim, it would affect the tax liability of all of the other partners. *Id.* "This is precisely the type of challenge prohibited by TEFRA in light of Congress's decision that such suits are better addressed in one fell swoop at the 'partnership level' than in countless suits by individuals partners." *Id.* Accordingly, the Seventh Circuit held that it lacked subject matter jurisdiction over the Kaplans' refund claim and affirmed the lower court's dismissal of the case. While the Kaplans' challenge was slightly

different than the Pratis' challenge, the applicability of the Seventh Circuit's holding is clear—challenges to partnership level items are more properly heard at the partnership level, and may not be heard in a subsequent partner-level proceeding, even if the results are harsh.

In *Weiner v. United States*, 389 F.3d 152, a case factually identical to the *Prati* case at bar, the Fifth Circuit reached the same conclusion as the Second and Seventh Circuit in *Chimblo* and *Kaplan*.[22] The plaintiffs in *Weiner*, like the Pratis, were members of an AMCOR-organized limited partnership and reported their proportional share of partnership losses on their personal income tax returns. Just like the Pratis' deductions, the plaintiffs' deductions in *Weiner* were subsequently disallowed by the IRS. The plaintiffs entered into settlement agreements with the IRS, and, after entering into the settlement agreements, argued that the assessments of tax and interest were untimely. Like the Pratis here, in order to avoid the jurisdictional bar of §7422(h), the plaintiffs then argued that their challenge under §6229(a) was not a partnership item because §6229(a) was located in Subtitle F of the tax code and not in Subtitle A.

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[22] Another similar Fifth Circuit decision is *Treaty Pines Inv. P'ship v. Comm'r of Internal Revenue*, 967 F.2d 206 (5th Cir. 1992). In *Treaty Pines*, the Fifth Circuit held that the Tax Court has jurisdiction at the partnership level to determine whether a settlement agreement with the IRS is valid. *Id.* at 210. The Fifth Circuit went on to state that once a partnership-level court determines a settlement is valid, it no longer had jurisdiction over the individual items because the settlement agreement changes the partnership items to nonpartnership items. *Id.*

However, the Fifth Circuit was not persuaded by those plaintiffs' argument. Relying on the reasoning of the Second and Seventh Circuits in *Chimblo* and *Kaplan*, the Fifth Circuit held that it lacked jurisdiction to decide the timely assessment issue: "because the FPAA limitations issue affects the partnership as a whole, it should not be litigated in an individual partner proceeding, as such a result would contravene the purposes of TEFRA." *Id.* at 156–57. In addition, the Fifth Circuit found the language of 26 C.F.R. §301.6231(a) to be persuasive, holding that "the treasury regulations have implicitly included the statute of limitations determination within the definition of 'partnership item.'" *Id.* at 157.

To counter the weight of all this existing case law, plaintiffs cite *Prochorenko v. United States*, 243 F.3d 1359 (Fed. Cir. 2001), as precedent that allegedly shows that this Court does have jurisdiction over plaintiffs' untimely assessment claim. Although it is binding on this Court, *Prochorenko* is clearly distinguishable and does not support the proposition for which it is cited.

In *Prochorenko*, the taxpayers claimed deductions on their personal tax returns based on their proportional share of a partnership's losses. After conducting an audit, the IRS disallowed the deductions, and issued a notice of FPAA. Several partners elected to challenge the FPAA in the Tax Court, and while the appeal was pending, several other partners entered into a settlement agreement with the IRS under terms that were more favorable than those in the FPAA. *Id.* at 1361. The Prochorenkos did not

enter into a settlement with the IRS, instead choosing to appeal the FPAA to the Tax Court and then the Second Circuit, both of which upheld the FPAA. *Id.* After conclusion of the appeal, another couple, the Colittis, "through [the] administrative grace" of the IRS, still managed to enter into a settlement agreement consistent with the original settlement that the nonchallenging partners entered into before the Tax Court and Second Circuit confirmed the FPAA. *Id.* Thereafter, the Prochorenkos sought to enter into a settlement consistent with the terms of the settlement the Colittis received.

When the IRS denied the Prochorenkos' request, the Prochorenkos filed suit in the Court of Federal Claims, seeking a reduction of their tax liability based on the Colittis' settlement. *Id.* at 1362. The Federal Circuit affirmed this Court's determination that a partner's right to request consistent settlement terms is not a partnership item. *Id.* "Whether or not the Prochorenkos were entitled to such a reduction is an issue that is entirely dependent on their own unique factual circumstances, and has no effect on and is not affected by the tax liability of any of the other partners . . . . [T]his is not the type of issue that is 'more appropriately determined at the partnership level.'" *Id.* at 1363.

Seizing on the determination that a request for consistent settlement terms is not a partnership item, the Pratis assert that their claim is similarly not a partnership item, and therefore not subject to the §7422(h) jurisdictional bar. Pls.' Resp. to Govt.'s Motion to Dismiss at 15. Nonetheless, the Pratis'

challenge is factually different than the Prochorenkos' consistent-settlement request. Unlike the Prochorenkos' consistent-settlement request, the Pratis' challenge deals with determinations related to the partnership as a whole, not matters that are unique to the Pratis themselves. The resolution of whether the Pratis' assessment was timely would be based on partnership-level determinations that affect other partners's returns. Accordingly, as explained above, this Court cannot hear the Pratis' challenge, as this Court lacks jurisdiction over the Pratis' untimely-assessment argument.

Finally, this Court agrees with the court in *Keener* that, like the plaintiffs in that case, plaintiffs here have waived their limitations objection. Because they could have pursued their limitations defense in the earlier partnership-level proceeding, but chose not to do so, "t he jurisprudence of both the Tax Court and this Court suggest that the limitations argument they now raise is not jurisdictional, but rather was an affirmative defense that, by their actions, was waived." *Keener*, 76 Fed. Cl. at 462 (citing *United States v. Hitachi America, Ltd.*, 172 F.3d 1319, 1333–34 (Fed. Cir. 1999); *Columbia Bldg., Ltd. v. Comm'r of Internal Revenue*, 98 T.C. 607, 611–12 (1992); *cf. John R. Sand & Gravel Co. v. United States*, 457 F.3d 1345, 1354 (Fed. Cir. 2006) (statute of limitations in 28 U.S.C. §2501 is jurisdictional and not waived), *aff'd*, 128 S. Ct. 750 (2008)). And like *Keener*, this Court holds that plaintiffs' tax settlement agreement with the IRS does "not render the above cases inapposite." *See Keener*, 76 Fed. Cl. at 463.

It is true that §6231(b)(1)(C) of the Code does convert partnership items into nonpartnership items when "the Secretary enters into a settlement agreement with the partner with respect to such items," and thus items previously treated as partnership items can become "individualized," rendering §7422(h) inapplicable. *See Keener*, 76 Fed. Cl. at 464; *Slovacek*, 40 Fed. Cl. at 829–30; *Olson*, 37 Fed. Cl. at 733. But the only items converted fall under the term "with respect to such items," that is, "such items" actually settled by an agreement.[23] The limitations contention, not being part of any settlement agreement, is thus not converted into a nonpartnership item.

For the Court to hold to the contrary would create an absurd result undercutting congressional intent in enacting TEFRA. As explained by the Fifth Circuit in *Weiner*—

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[23] The view that "such items" refers only to those items actually covered by an agreement is fortified by *Keener*'s construction of several other subparagraphs in §6231(b)(1), such as §6231(b)(1)(A), which provides that "partnership items shall become nonpartnership items as of the date the Secretary mails to such partner a notice that 'such items' shall be treated as nonpartnership items," *Keener*, 76 Fed. Cl. at 464, and §6231(b)(2)(B)(I), which states that this notice may be provided "as to one or more of such [partnership] items" the connotation being that "less than all the available partnership items need be converted." *Id.* Construing these subparagraphs in a coherent and consistent manner, *see, e.g.*, *Helvering v. Stockholms Enskilda Bank*, 293 U.S. 84, 88–89 (1934); *Fortec Constr. v. United States*, 760 F.2d 1288, 1292 (Fed. Cir. 1985), the court rightly maintained that the meaning of "such items" can refer only to those items actually settled or agreed upon. *Keener*, 76 Fed. Cl. at 464–65.

> partners could settle with the IRS and thus eliminate their ability to participate in and be bound by the result of any partnership-level proceeding. But if, as here, the Tax Court decided the substantive statute of limitations issue against the partnership, the settling partners could simply bring individual partner-level suits in the district courts and attempt to obtain a different ruling on the statute of limitations issue. Thus, some partners would be required to pay the assessed deficiency, while others would not. The result advocated by the taxpayers here is at odds with TEFRA's goal of consolidating decisions that affect the partnership as a whole.

Weiner, 389 F.3d at 158.

C. Does Jurisdiction Lie To Consider Pratis' Claim That Interest Assessed under 26 U.S.C. §6621(c) Was Improper?

The government contends that this Court lacks jurisdiction under §7422(h) to adjudicate plaintiffs' claim that the IRS erred in asserting interest against them under the former "sham transaction" provision of 26 U.S.C. §6621(c) (*repealed* 1990), because the determination of partnership sham transactions are partnership items that should have been challenged by the Pratis at the partnership level proceeding after the IRS issued the notice of FPAA. Govt.'s Motion for Partial Dismissal of Plaintiffs' Complaint at 8. The government further contends that because the Pratis entered into partial settlement agreements after the FPAA was issued, and the settlement agreements did

not cover the FPAA sham transactions, the Pratis are bound by the FPAA determination. *Id.* at 18.

In response to the government's jurisdictional argument, plaintiffs assert that their refund claim is not a partnership item, and claim that the reasoning of *Field v. United States*, 328 F.3d 58 (2d Cir. 2003) and *Prochorenko*, 243 F.3d 1359, support them. Pls.' Brief in Support of his Opposition to the Govt.'s Motion for Partial Dismissal at 10. The Pratis also maintain that the settlements agreements in which they entered were complete settlements, and thus they were not bound by the FPAA determination that the partnerships' transactions were shams. *Id.*

The Pratis also move for summary judgment with regard to their §6621(c) penalty interest refund claim, asserting that the penalty interest assessed against them under §6621(c) was improper as a matter of law. Pls.' §6621(c) Motion for Partial Summary Judgment at 14. The Pratis contend that the settlement agreements in which they entered did not express any specific grounds for the disallowance of their deductions so they do not preclude their challenge to the penalty interest. *Id.* at 15. The Pratis further state that, by allowing almost two-thirds of the Pratis' claimed deductions in their settlements, the IRS implicitly agreed that the deductions were not shams under the formula used by the IRS in imposing the penalty interest. *Id.* at 28.

Turning to the merits of the parties' arguments, the starting point must be analysis of the controlling

statute. Enacted in 1984 and repealed in 1990,[24] §6621(c) imposed a penalty rate at 120 percent of the statutory interest rate when the IRS determined that the taxpayer's substantial underpayment of taxes was attributable to so-called "tax-motivated transactions."[25] In relevant part, §6621(c) provided:

> [W]ith respect to any substantial underpayment attributable to tax motivated transactions, the annual rate of interest established under this section shall be 120 percent of the underpayment rate. . . .
>
> For purposes of this subsection, the term "tax motivated transaction" means . . . any sham or fraudulent transaction.

26 U.S.C. §6221(c). Subsection (c)(3) of 26 U.S.C. §6221, defined "tax motivated transactions" as "any loss disallowed by reason of section 465(a)" and "any

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[24] The Senate sponsor of the repealing legislation not unreasonably described the penalty structure of the 1986 tax code as a "morass of inconsistency and irrationality." 135 CONG. REC. S13893-07 (1989).

[25] Upon enactment in 1984, this provision was codified as 26 U.S.C. §6621(d). It was amended and redesignated as 26 U.S.C. §6621(c) by the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2744, §1511(c)(1)(A)–(C). Section 6621(c) applies to interest accruing after December 31, 1984, even if the transaction were entered into before the date of its enactment. Tax Reform Act of 1984, §144(c), Pub. L. No. 98-369, Div. A, July 18, 1984, 98 Stat. 494 (1984). Despite its repeal, §6 S. REP. NO. 621(c) remains applicable to tax years prior to 1989. *See* 94-938 at 47–49 (1976), *see also Comm'r of Internal Revenue v. Tufts*, 461 U.S. 300, 309 n.7 (1983).

sham or fraudulent transaction." 26 U.S.C. §6621(c)(3)(ii), (v).

Section 465, the so-called "at risk" provision, was added to the Code in 1976 to prevent the creation of tax shelters through which taxpayers could effectively avoid any financial risk. It provides that an individual's loss deductions shall be allowed "only to the extent . . . to which the taxpayer is at risk." 26 U.S.C. §465(a)(1). A taxpayer is considered "at risk" for an activity for the amount of money contributed to that activity, or any amount borrowed for that activity. 26 U.S.C. §465(b). A taxpayer is not considered "at risk" for "amounts protected against loss through nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements." 26 U.S.C. §465(b)(4). With regard to an "at risk" determination, logic dictates that it is the individual partner who is the "taxpayer" to whom these "at risk" rules apply, since partnerships do not qualify as taxpayers for purposes of the Code. Nevertheless, courts addressing the matter "must often consider not only what the partner contributed to the partnership, but the nature of the obligations flowing among the partner, the partnership, and, at times, third-parties." *Keener*, 76 Fed. Cl. at 467. Thus, "several cases directly involving the 'at risk' provisions have concluded that their application is not a 'nonpartnership item,' but rather an affected item." *Id.* (citing *Ginsburg v. Comm'r of Internal Revenue*, 127 T.C. 75, 92–93 (2006); *Greenberg Bros. P'ship # 4 v. Comm'r of Internal Revenue*, 111 T.C. 198, 202 (1998); *Hambrose Leasing 1984-5 Ltd. P'ship v. Comm'r of Internal Revenue*, 99 T.C. 298,

312–13 (1992); *Roberts v. Comm'r of Internal Revenue*, 94 T.C. 853, 861 (1990)).[26]

The "sham or fraudulent transaction" prohibition prong of 26 U.S.C. §6221(c)(3), the prong at issue in the instant case, is a more difficult nut to crack. In fact, case law has developed two differing "tests" for identifying shams. The Fourth Circuit has adopted a two-prong standard providing that "[t]o treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits . . . and that the transaction has no economic substance because no reasonable possibility of a profit exists." *Rice's Toyota World Inc. v. Comm'r of Internal Revenue*, 752 F.2d 89, 91 (4th Cir. 1985). Notwithstanding, a majority of the circuits follow a more flexible test developed by the Ninth Circuit, whereby "the consideration of business purpose and economic substance are simply more precise factors to consider in the [determination of] whether the transaction had any practical economic effects other than the creation of income tax losses." *Sochin v. Comm'r of Internal Revenue*, 843 F.2d 351, 354 (9th Cir. 1988); *see also Winn-Dixie Stores, Inc. v. Comm'r of Internal Revenue*, 254 F.3d 1313, 1316 (11th Cir. 2001); *True v. United States*, 190 F.3d 1165, 1177

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[26] Accordingly, "issues involving items such as the nonrecourse character of partnership notes or the economic substance of partnership transactions are to be resolved in a partnership-level proceeding, with those determinations then being binding on the partners in any refund litigation that would ensue." *Keener*, 76 Fed. Cl. at 467 (citing *Greenberg Bros. P'ship*, 111 T.C. at 202; *Hambrose Leasing*, 99 T.C. at 312).

n.11 (10th Cir. 1999); *CM P'ship v. Comm'r of Internal Revenue*, 157 F.3d 231, 247 (3d Cir. 1998); *DeMartino v. Comm'r of Internal Revenue*, 862 F.2d 400, 406 (2d Cir. 1998); *Rose v. Comm'r of Internal Revenue*, 868 F.2d 851, 854 (6th Cir. 1989).

What is paramount, however, is that when determining sham or fraudulent transactions, under either of the two tests, courts have concluded that the determination must be done on the partnership level. *See Transpac Drilling Venture, 1983-2 by Dobbins v. United States*, 32 Fed. Cl. 810, 820 (1995), *aff'd*, 83 F.3d 1410 (Fed. Cir. 1996); *Nault v. United States*, 2007 WL 465310 at *4–*5 (D.N.H. Feb. 9, 2007); *see also Keener*, 76 Fed. Cl. at 468. This is because "[t]he focus is on the *partnership*'s motivation for entering into the relevant business transaction, 'not on an individual partner's motive for joining the partnership.'" *Keener*, 76 Fed. Cl. at 468 (citing *Tallal v. Comm'r of Internal Revenue*, 778 F.2d 275, 276 (5th Cir. 1985) (emphasis added).

This unanimity, however, breaks down on the issue of whether the *imposition of interest* under §6621(c) may be raised at the partner level. On one side, some courts have held that §6621(c) interest is an affected item and not a partnership item, but have interpreted the term "affected item" in a manner (unlike this Court) allowing jurisdiction to challenge the propriety of §6621(c) interest assessment in a partner level proceeding. *See Field v. United States*, 328 F.3d at 59 (holding that the §6621(c) interest being authorized by a provision in subtitle F of the Code, and not specifically within the regulatory definition contained

in Treas. Reg. §301.6231(a)(3)-1, is an affected item that can be challenged at a partner-level proceeding); *see also Klein v. United States*, 86 F. Supp. 2d at 698 n.12; *Korchak*, 90 T.C.M. at 416; *Affiliated Equipment Leasing II v. Comm'r of Internal Revenue*, 97 T.C. 575 (1991). On the other side of the ledger, courts (like this one) have held that challenges to §6621 interest must be made at the *partnership* level, not at the partner level. *See River City Ranches #1 Ltd. v. Comm'r of Internal Revenue*, 401 F.3d 1136, 1143 (9th Cir. 2005) (holding that the sham nature of the partnerships' transactions is a "partnership item" because it is required to be taken into account . . . under . . . [the income tax provisions] of subtitle A" thus affecting the income tax of the individual partners); *see also Keener*, 76 Fed. Cl. at 468–70; *Ertz v. Comm'r of Internal Revenue*, 2007 WL 174133 (T.C. Jan 24, 2007).

Although the *River City Ranches #1 Ltd.* court did not delve into the minutiae of tax technicality concerning the distinction between a "partnership item" and an "affected item," its reasoning is sound and should control regardless of which category is applied. *See Keener*, 76 Fed. Cl. at 468–71. This is particularly true if, as here, the §6621(c) "tax-motivated transaction" claimed is alleged to be a sham transaction—obviously, what constitutes a sham perpetrated by members of the partnership must be resolved initially in a partnership-level proceeding before any refund action lies to determine whether

interest should be imposed on an individual partner.[27] Indeed, going full circle by applying the lessons learned in the prior section, it is clear that plaintiffs were given notice by assertions specifically made in the 1991 FPAA that one of the issues in the partnership proceeding was to be whether the partnership's activities constituted a sham transaction that lacked economic substance. Plaintiffs chose to settle their tax liability, and by not challenging the sham transaction allegations, they cannot now be heard on this issue. This Court simply has no jurisdiction.

D. Is the Abuse of Discretion for Failure To Abate Claim Viable?

The Pratis' second alternative claim is that the Secretary of the Treasury abused his discretion when he refused to abate the penalty interest accrued against the Pratis, pursuant to 26 U.S.C. §6404(e)(1). Section 6404 provides, in part:

> The Secretary is authorized to abate the unpaid portion of the assessment of any tax or any tax liability in respect thereof . . . .
>
> (e) (1) In the case of any assessment of interest on (a) any deficiency attributable in whole or in part to any unreasonable error or delay by an officer or employee of the Internal Revenue service (acting in his official capacity) in

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[27] The requirement of an initial resolution at the partnership level also applies to penalties imposed pursuant to the "at risk" rules of §465, to the extent that penalty interest involves the nonrecourse character of partnership notes or the economic substance of partnership transactions.

> performing a ministerial or managerial act . . . the Secretary may abate the assessment of all or any part of such interest for any period.

26 U.S.C. §6404. The Pratis claim that interest accrued during the IRS's investigation of the Partnerships should be abated, as the investigation was full of unreasonable errors and delays by IRS officials acting in their official capacity.

This Court does not need to resolve this issue, being bound by the Supreme Court decision in *Hinck v. United States*, 127 S. Ct. 2011 (2007), *aff'g* 446 F.3d 1307 (Fed. Cir. 2006). In affirming the Federal Circuit in *Hinck*, the Supreme Court held that the district courts and the Court of Federal Claims lack jurisdiction to hear cases regarding the abatement of interest attributable to unreasonable errors and delays by the IRS—only "the Tax Court provides the exclusive forum for judicial review of a refusal to abate interest under §6404(e)(1) . . . ." 127 S. Ct. at 2013. Therefore, the Pratis' request for review of abatement of interest pursuant to 26 U.S.C. §6404 must be dismissed. This Court is bound by controlling authority. *See Coltec Industries, Inc.*, 454 F.3d at 1353 ("there can be no question that the Court of Federal Claims is required to follow the precedent of the Supreme Court, our court, and our predecessor court, the Court of Claims").

III. CONCLUSION

For the forgoing reasons, the motions of the United States are **GRANTED** because the Court finds that it does not have jurisdiction to hear the plaintiffs' challenge to the timeliness of their tax assessment, as

well as their alternative tax-motivated interest penalty and tax abatement claims. Accordingly, all claims by the plaintiffs are hereby **DISMISSED** for lack of jurisdiction and plaintiffs' motion for summary judgment is **DENIED**. Furthermore, it is **ORDERED** that all 76 other related cases cited in footnote 2 of this opinion are hereby **DISMISSED** for lack of jurisdiction. Additionally, the Court notes that orders in the cases Isler, 01-344 T, Scuteri, 01-358 T, and Penni, 04-1818 T, will be issued requesting the parties to confer and file a Joint Status Report by May 16, 2008, regarding how best to proceed with the other cases enumerated in footnote 7.

IT IS SO ORDERED.

s/Lawrence J. Block
Lawrence J. Block

Judge

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2002

(Argued: April 11, 2003 Decided: May 2, 2003)

Docket No. 02-6163

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DAVID A. FIELD and ELLEN J. FIELD,

Plaintiffs-Appellants,

-v.- 02-6163

UNITED STATES OF AMERICA,

Defendant-Appellee.

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Before: HON. DENNIS JACOBS,
HON. CHESTER J. STRAUB,
Circuit Judges,
HON. GREGORY W. CARMAN,
Chief Judge.[1]

Appeal from a judgment, entered in the United States District Court for the Southern District of New York (Scheindlin, J.), dismissing a complaint for lack of subject matter jurisdiction.

Vacated and remanded.

ELLIOT I. MILLER, New York, NY

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[1] Honorable Gregory W. Carman, Chief Judge of the United States Court of International Trade, sitting by designation.

(David A. Field, on the brief), for Plaintiffs-Appellants David A. Field and Ellen J. Field.
MICHAEL M. KRAUSS, Assistant United States Attorney for the Southern District of New York (James B. Comey, United States Attorney, and Jeffrey S. Ostericher, Assistant United States Attorney, on the brief), for Defendant-Appellee United States of America.

PER CURIAM:

The sole issue on appeal is whether the district court had jurisdiction over Plaintiffs-Appellants' tax refund action. This Court holds that jurisdiction is not foreclosed by 26 U.S.C. §7422(h) (2000) and that the district court can properly exercise jurisdiction over this matter. Therefore, the district court's decision is reversed and the case is remanded for consideration of the merits of the action.

District courts generally have subject matter jurisdiction over tax refund claims pursuant to 28 U.S.C. §1346(a)(1). However, under 26 U.S.C. §7422(h), "[n]o action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c)."[2] Based on a plain language reading of the

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[2] Neither exception to §7422(h) is applicable to this case. Plaintiffs-Appellants do not seek a refund based upon a computational error under §6230(c), nor do Plaintiffs-Appellants seek review of the Internal Revenue Service's ("IRS") denial of a

statute, this provision does not bar jurisdiction. The statute indicates that for jurisdiction to be foreclosed, the refund (not the item which leads to that refund) must be attributable to partnership items. In other words, the refund must be based upon the assessment of a partnership item. This reading is further supported by the inclusion of the parenthetical reference to §6231(a)(3), which defines a "partnership item." Contrary to the United States' argument, the provision does not appear to bar jurisdiction in refund actions regarding a category of items that are termed "attributable to partnership items." Thus, it is only with respect to partnership items that a refund action is precluded. "If the refund is attributable to partnership items, section 7422(h) applies and deprives the court of jurisdiction. If, on the other hand, the refund is attributable to nonpartnership items, then section 7422(h) is irrelevant, and the general grant of jurisdiction [in 28 U.S.C. §1346(a)(1)] is effective." *Alexander v. United States*, 44 F.3d 328, 331 (5th Cir. 1995).

There are three factors which lead this Court to find that the interest assessed against Plaintiffs-Appellants under former 26 U.S.C. §6621(c) is not a partnership item. First, the statutory definition of a "partnership item" is "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the

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request for an administrative adjustment under §6228(b).

partnership level than at the partner level." 26 U.S.C. §6231(a)(3). The IRS's regulations list items considered to be partnership items. Thus 26 C.F.R. §301.6231(a)(3)-1 states that "the following items which are required to be taken into account for the taxable year of a partnership under subtitle A of the [Internal Revenue] Code are more appropriately determined at the partnership level than at the partner level and, therefore, are partnership items," and then lists various items, which do not include interest or §6621(c) interest. 26 C.F.R. §301.6231(a)(3)-1. Additionally, former 26 U.S.C. §6621(c) was a part of subtitle F and therefore was not an item "to be taken into account . . . under subtitle A." *Id.* Thus, the statutory definition of a "partnership item" and the IRS's regulations indicate that the §6621(c) interest is not a partnership item. The refund that Plaintiffs seek is therefore not attributable to a partnership item.

Second, the United States Tax Court has previously denied jurisdiction over claims regarding §6621(c) interest on the ground that the §6621(c) interest is not a partnership item. For example, in *Affiliated Equipment Leasing II*, the Tax Court noted its prior holding that it "lack[s] jurisdiction in a partner level proceeding to determine whether a petitioner is liable for increased interest under section 6621(c) where the only matters in dispute were additions to tax" and concluded that "section 6621(c) interest is not a 'partnership item' and is not within the [Tax] Court's scope of review in a partnership level proceeding." *Affiliated Equip. Leasing II v. Commissioner*, 97 T.C. 575, 576-78 (1991) (citing *White v. Commissioner*, 95 T.C. 209, 212 (1991)). As recently as 2000, the Tax

Court determined that §6621(c) interest is an "affected item"(as defined in the margin below)[3] rather than a "partnership item" and therefore could not be reviewed at a partnership level proceeding. *Barlow v. Commissioner*, Nos. 4651-95, 4652-95, 6393-95, 6394-95, 2000 Tax Ct. Memo LEXIS 402, at *47-*51 (T.C. Nov. 3, 2000) ("Additional interest under section 6621 is an affected item because the determination of a taxpayer's liability for such interest may require findings of fact peculiar to the particular taxpayer, namely, the amount of the taxpayer's underpayment that is attributable to a tax-motivated transaction. Because the application of section 6621(c) turns on matters that are specific to individual partners, it follows that such interest constitutes an affected item that cannot be reviewed in a partnership level proceeding.") (citations omitted). These cases reinforce the view that the penalty interest at issue in this case is not attributable to a partnership item.

Third, the parties agree that the §6621(c) interest at issue is not a "partnership item." Counsel for the United States conceded at oral argument that the item at issue is not a partnership item but rather is properly

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[3] An "affected item" is defined as "any item to the extent such item is affected by a partnership item." 26 U.S.C. §6231(a)(5). As the Tax Court noted in *Barlow*, there are two types of affected items. The first type "is a computational adjustment made to record the change in a partner's tax liability resulting from the proper treatment of a partnership item." *Barlow*, 2000 Tax Ct. Memo LEXIS 402, at *49 (citation omitted). The second type is an item "that is dependent on factual determinations to be made at the individual partner level." *Id.* at *50. The Tax Court found that §6621(c) interest is the latter type of affected item. *Id.* at *50-*51.

considered an affected item. Plaintiffs have consistently argued that the penalty interest is not a partnership item. The United States argues that §7422(h) should be read to bar jurisdiction over claims for refunds where the item to be refunded is "attributable to a partnership item," meaning it directly flows from a partnership item. As discussed, a plain reading of §7422(h) defeats of this argument.

For the reasons set forth above, the judgment of the district court is hereby vacated and the matter remanded for consideration on the merits.

United States Court of Appeals
for the Federal Circuit

2008-5045

JADE TRADING, LLC, by and through, ROBERT W. ERVIN and LAURA KAVANAUGH ERVIN on behalf of ERVIN CAPITAL, LLC, Partners Other Than the Tax Matters Partner,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

David D. Aughtry, Chamberlain, Hrdlicka, White, Williams & Martin, of Atlanta, GA, argued for plaintiffs-appellants. With him on the brief were Nicolas F. Kory; and Linda S. Paine, of Houston, TX.

Joan I. Oppenheimer, Attorney, Appellate Section, Tax Division, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With her on the brief were Gilbert S. Rothenberg, Acting Deputy Assistant Attorney General, and Richard Farber, Attorney.

Appealed from: United States Court of Federal Claims

Judge Mary Ellen Coster Williams

United States Court of Appeals for the Federal Circuit

2008-5045

JADE TRADING, LLC, by and through, ROBERT W. ERVIN and LAURA KAVANAUGH ERVIN on behalf of ERVIN CAPITAL, LLC, Partners Other Than the Tax Matters Partner,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in 03-CV-2164, Judge Mary Ellen Coster Williams

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DECIDED: March 23, 2010

Before LOURIE, ARCHER, and LINN, Circuit Judges.

ARCHER, Circuit Judge.

JadeTrading, LLC ("Jade") appeals the Court of Federal Claims' denial of its petition for readjustment of the partnership items of Jade and its affirmance of the Internal Revenue Service's ("IRS" or "Service") application of penalties at the partnership level without consideration of the partners' reasonable cause defense. Jade Trading v. United States, 80 Fed.Cl. 11 (2007). Because the contribution of euro call options to Jade (hereinafter sometimes called the spread

transaction) was a transaction that lacked economic substance, we affirm the Court of Federal Claims' denial of Jade's petition. Further, we hold that the Court of Federal Claims lacked jurisdiction to review the application of penalties based on the outside bases of Jade's partners, and we therefore vacate that portion of the court's judgment and remand for further proceedings. We also vacate as moot the Court of Federal Claims' determination that Temp. Treas. Reg. §301.6221-1T(c), (d) is not invalid.

I

A

This case is governed by certain provisions of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"). See 26 §§U.S.C. 6221-31 (1998).[1] Prior to TEFRA's enactment, tax liability adjustments of individual partners based on the operations of the partnership were rendered at the partner level. "TEFRA was intended, in relevant part, to prevent inconsistent and inequitable income tax treatment between various partners of the same partnership resulting from conflicting determinations of partnership level items in individual partner proceedings." RJT Invs. X v. Comm'r Internal Revenue, 491 F.3d 732, 737 (8th Cir.2007). Under TEFRA, all "partnership items" are determined in a single proceeding. 26 U.S.C. §6221.[2] The results of this

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[1] Hereinafter, Title 26 U.S.C. is referred to as "the Tax Code."

[2] Section 6221 of the Tax Code states "[e]xcept as otherwise provided in this subchapter, the tax treatment of any partnership

proceeding then apply to each individual partner's income tax return. If a partner wishes to challenge any adjustment to his income tax return or to assert any partner-level defenses, he may file a partner level refund suit. 26 U.S.C. §6230(c).

B

This case involves a tax shelter designed to produce large, artificial, i.e., noneconomic, losses for tax purposes. JadeTrading, 80 Fed.Cl. at 20. In general, the tax shelter here involved four steps: "1) Investment in Foreign Currency, 2) Contribution to a Partnership, 3) Partnership Investments, 4) Termination of Partnership Interests." Id. at 24-25 (describing tax opinion prepared for potential investors by BDO Seidman, a national accounting and tax consulting firm). The investor first simultaneously purchased a European-style call option and sold a European-style call option.[3] Id. at 25. The investor next contributed the purchased and sold call options to a partnership. Id. The investor eventually exited the partnership, received an asset with a claimed high-basis and low-value, and then sold that asset in order to generate a tax loss. Id. A tax loss was anticipated because, at the time of the facts giving rise to this case, an

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item (and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item) shall be determined at the partnership level."

[3] An option is a contract that gives the buyer the right, but not the obligation, to buy or sell an asset at a predetermined price (the strike price). A European-style option is an option that can only be exercised on its expiration date.

investor's basis in a partnership was ordinarily not decreased by the amount of a contingent liability contributed to or assessed by a partnership. See Helmer v. Comm'r, 34 T.C.M. (CCH) 727 (1975) (holding that a contingent obligation, such as an option, was not a liability under §752 of the Tax Code because a partnership's obligation under the option does not become fixed until the option is exercised).[4]

C

The parties do not disagree with the basic facts found by the Court of Federal Claims. Therefore, we recite only those facts relevant to this decision.

Robert W. Ervin and his two brothers were equal partners in a cable business, which they sold in 1999. The sale proceeds received in March 1999 resulted in a total gain to each brother of approximately $13,500,000. Because the buyer was a publicly traded company, the transaction was disclosed to the Securities Exchange Commission. Thereafter, the Ervins received numerous offers of investment and tax advice. After considering a number of these investment and tax proposals, the following transaction at issue here was entered into by the Ervin brothers.

In September 1999, the Ervin brothers each formed a single-member LLC. On September 15, 1999, each Ervin LLC entered into a separate master trading agreement with AIG, and each paid AIG an $84,100

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[4] The sold call option contributed to the partnership in this case is similarly a contingent obligation that does not become fixed until it is exercised.

"account opening fee" pursuant to this agreement. On September 29, 1999, each Ervin LLC purchased from AIG a call option on the euro at a strike price of 1.0840 ("purchased call option") for $15,000,020 and sold to AIG a call option on the euro at a strike price of 1.0850 ("sold call option") for $14,850,018. The options were all European-style options that expired on September 29, 2000, and had a face amount of 290,540,000 euros. Each Ervin LLC paid AIG only the difference in the premiums of the offsetting options, or $150,002.

On October 2, 1999, each Ervin LLC entered into a fifteen-month "consulting agreement" with New Vista, LLC (an affiliate of Sentinel Advisors, LLC), which required each Ervin LLC to pay New Vista $750,000 for "consulting services." Payment of this fee was a prerequisite to the Ervin LLCs being admitted to the Jade partnership. Jade was formed by Sentinel and Banque Safra, a Luxembourg financial institution, on September 23, 1999, with Sentinel as the managing partner. On October 6, 1999, each Ervin LLC entered Jade as a partner. On that same day, each Ervin LLC contributed the above described euro call options to Jade, as well as $75,000 cash. In December 1999, each Ervin LLC withdrew from Jade. Each Ervin LLC's interest in assets distributed to it by Jade was valued at $126,122. The distributed assets consisted of Xerox stock, which was sold in 1999, and euros.

On its partnership return for 1999, Jade reported on its Schedule K (Partners' Shares of Income, Credits, Deductions, etc.) a loss of $292,015. Each of the Ervin brother's individual income tax return for 1999 claimed approximately $15 million in tax losses from his

execution of the spread transaction and involvement in Jade. These tax losses resulted from each brother's increasing the basis of his interest in Jade ("outside basis") by the cost of the purchased call option ($15 million) and not decreasing this basis by the amount of the potential liability that Jade assumed under the sold call option.

After auditing the Jade partnership return, the IRS issued a final partnership administrative adjustment ("FPAA") to Jade with respect to Jade's partnership items for the 1999 tax year. The FPAA determined that the Jade partnership should be disregarded and all transactions engaged in by Jade should be treated as being engaged in directly by the purported partners, including the Ervin LLCs. Thus, the FPAA disallowed the deductions claimed for losses purportedly incurred from the contribution of the spread transactions to Jade. The FPAA also disallowed the losses claimed by Jade and reduced Jade's claimed distributions of property to zero. The IRS also imposed accuracy-related penalties under §6662 of the Tax Code.

Subsequently, Jade filed a petition for readjustment of the partnership items of Jade in the Court of Federal Claims. The court upheld the IRS's determination, concluding that Jade had not met its burden of demonstrating that the contribution of the spread transactions to Jade objectively had economic substance. Jade Trading, 80 Fed.Cl. at 14. The court also affirmed the penalties determined by the IRS at the partnership level without considering the

reasonable cause defenses that the partners might have. Id. at 60.

Jade appealed, and we have jurisdiction under 28 U.S.C. §1295(a)(3).

II

A

We review de novo the Court of Federal Claims' conclusion that the contribution of the spread transaction to Jade lacked economic substance. Coltec Indus., Inc. v. United States, 454 F.3d 1340, 1357 (Fed.Cir.2006). However, we review the court's factual findings underlying this conclusion for clear error. SCS Hosp. Sys., Inc. v. Montefiore Hosp., 732 F.2d 1572, 1578 (Fed.Cir.1984). Finally, we review the court's jurisdictional determinations de novo. Distributed Solutions, Inc. v. United States, 539 F.3d 1340, 1343 (Fed.Cir.2008).

B

The Court of Federal Claims held that the Ervin LLCs' contributions of the spread transactions to Jade lacked economic substance. We agree.

The economic substance doctrine "require[s] disregarding, for tax purposes, transactions that comply with the literal terms of the tax code but lack economic reality." Coltec, 454 F.3d at 1352. In Coltec we discussed the economic substance doctrine in detail, leaving no question as to its viability. We explained that the doctrine "represents a judicial effort to enforce the statutory purpose of the tax code." Id. at 1353. The doctrine, "[f]rom its inception, ... has been used to

prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a tax benefit." Id. at 1353-54. In Coltec, after examining cases from the Supreme Court, various courts of appeals, and our predecessor court, we concluded that the economic substance doctrine incorporated five general principles. Specifically, we opined that 1) the transaction cannot lack economic reality; 2) the taxpayer bears the burden of proving that the transaction has economic substance; 3) the economic substance of a transaction must be viewed objectively rather than subjectively; 4) the transaction to be analyzed is the one that gave rise to the alleged tax benefit; and 5) arrangements with subsidiaries that do not affect the economic interests of independent third parties deserve particularly close scrutiny. Id. at 1355-57. We also explained that "a lack of economic substance is sufficient to disqualify the transaction without proof that the taxpayer's sole motive is tax avoidance." Id. at 1355.

The Ervin LLCs' transfer of the spread transactions to Jade lacked economic substance. The Ervin LLCs purchased euro call options from AIG for a premium of $15,000,020 and sold euro options to AIG for a premium of $14,850,018. However, the Ervin LLCs paid AIG only the difference-a net premium of $150,002. After contributing the spread transactions to Jade and subsequently exiting the partnership, the Ervins claimed a basis of over $15 million in their Jade interests by including only the cost of the purchased call option. As a result, the artificially inflated basis generated a purported $14.9 million tax loss.

As the Court of Federal Claims noted, this loss was "purely fictional." JadeTrading, 80 Fed.Cl. at 45. Each Ervin LLC did not invest $15 million in the spread transaction contributed to Jade and did not lose almost $15 million upon exiting Jade. Neither option was, in fact, exercised. Thus, each Ervin LLC had a real loss of approximately $100,000 upon exiting Jade-the difference between its capital contribution of $225,000 to the Jade partnership and its redemption proceeds of $126,122 received from Jade.

Additionally, the formation of the Jade partnership appears to have had no economic purpose. The partnership did nothing to enhance the investment potential of the spread transaction. Id. at 46. However, for tax purposes, it was imperative that the individual partners contribute the spread transactions to Jade to generate the artificially inflated bases.

Also significant is the Court of Federal Claims' determination that the spread transaction was virtually guaranteed to be unprofitable. Each Ervin LLC was required to pay an $84,100 account opening fee to AIG and a $750,000 New Vista consulting fee.[5]

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[5] In its findings, the Court of Federal Claims also included fees for an opinion letter prepared by Curtis Mallet. It is unclear whether each Ervin LLC was "required" to purchase the $100,000 tax opinion letter. However, given that the letter was requested to cover "certain aspects of United States Federal income tax in connection with (i) investments in foreign currency that [the Ervins had] made and (ii) transactions in which [they] engaged with a partnership ... that trades in foreign currency," Jade Trading, 80 Fed.Cl. at 33, it is likely that the Ervins felt compelled to purchase the letter. The inclusion or absence of this fee does not change our analysis.

Thus, each Ervin LLC spent at least $834,100 for the chance at making a profit of $140,000.[6] No reasonable investor would engage in such a transaction to earn a profit. The Court of Federal Claims concluded, and we agree, that

> This transaction's fictional loss, inability to realize a profit, lack of investment character, meaningless inclusion in a partnership, and disproportionate tax advantage as compared to the amount invested and potential return, compel a conclusion that the spread transaction objectively lacked economic substance.

Id. at 14. As the Court of Federal Claims found, this spread transaction and its contribution to Jade "was developed as a tax avoidance mechanism and not as an investment strategy" by the BDO Seidman accounting firm. Id.

Jade argues that the contribution of the spread transactions to Jade had economic substance because the purchased call options and the sold call options were separate assets with separate documentation and were owned by unrelated parties. The Court of Federal Claims concluded that "the economic realities of the

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Additionally, the fees listed above do not include Sentinel's 2% management fee or its 20% incentive fee, or the 5% penalty for early withdrawal from Jade (which applied if the Ervin LLCs withdrew from Jade prior to 12 months from entering the partnership, which they did).

[6] This is calculated by subtracting the cost of each spread transaction ($150,002) from its maximum payoff ($290,540) that could occur due to the different option prices.

spread transaction contributed to Jade made it impossible to delink the option pairs," explaining:

> If the Ervin LLCs had wished to hold only the long position-that is, the option they purchased from AIG-they would have faced the prospect of theoretically unlimited gain.... To obtain that position, the Ervin LLCs would have been required to pay AIG the full face amount of the premium, about $15 million each, to purchase the options. Neither the Ervin LLCs nor Jade ever had sufficient funds to make such a payment. Moreover, under this scenario, the entire amount would have been at risk; had the euro not risen to 1.084, each Ervin LLC would have lost the entire $15 million premium it paid to AIG.
>
> Had the Ervin LLCs wished to hold on the short option sold to AIG, they would have faced the prospect of theoretically unlimited loss, as AIG would have benefitted in any rise of the euro above 1.085, not capped in any way. Because such a transaction would be uncovered, AIG would have had extensive credit concerns. The Ervin LLCs would not have received the premiums to which they would be theoretically entitled, because AIG would have retained those premium payments as margin, because AIG would not have had the spread's protection from loss. AIG would have required that the Ervins post margin in the amount of at least $8 million each. In sum, under the agreement with AIG, the Ervins could not separate the components of

> the spread without AIG's permission which would not likely have been forthcoming without the required margin.

Id. at 50-51 (citations to record omitted). As the government's expert explained, "[t]he spread strategy component options were priced together, purchased together, contributed to Jade together, and closed out by Jade together, and at no time during their lives did either the Ervin LLCs or Jade have the means to separate the component options." [JA 5817] The Court of Federal Claims concluded that "the transactions here cannot be separated because they were totally dependent on one another from an economic and pragmatic standpoint." Id. at 51. Jade has not persuaded us that this conclusion is in error.

Accordingly, we affirm the Court of Federal Claims' judgment that the contribution of the spread transactions to Jade lacked economic substance and should be disregarded for tax purposes.

C

Jade asserts that the Court of Federal Claims does not have jurisdiction to review the penalties imposed by the IRS based on the Ervins' outside bases in Jade.

Section 6226 of the Tax Code is TEFRA's judicial review provision. Specifically, §6226(f) grants the trial court (either the Court of Federal Claims or the United States Tax Court):

> jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership

> administrative adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.

26 U.S.C. §6226(f) (emphases added).[7]

Jade contends that because the Ervins' outside bases in Jade, upon which the assessed penalties are based, are not partnership items, there could be no penalty applicable to a partnership item to trigger the court's penalty jurisdiction under §6226(f).

The government responds that while a partner's outside basis is an affected item and thus not itself a partnership item, most (if not all) of the components of a partner's outside basis are themselves partnership items. The government further argues that since all "legal and factual determinations that underlie the determination of the amount, timing, and characterization" of partnership items are themselves partnership items, the lack of economic substance of the spread transactions contributed to Jade is a partnership item.

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[7] Under TEFRA, a "partnership item" is "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A ... provided that ... such item is more appropriately determined at the partnership level than at the partner level." 26 U.S.C. §6231(a)(3). TEFRA further defines two other terms, namely, a "nonpartnership item" and an "affected item." A "nonpartnership item" is one that is not a "partnership item." 26 U.S.C. §6231(a)(4). And an "affected item" is one that is affected by a "partnership item." 26 U.S.C. §6231(a)5.

In a factually analogous case, the D.C. Circuit considered whether §6226(f) conferred jurisdiction on the trial court, in that case the Tax Court, to determine that the partners had no outside bases in a partnership that was disregarded for tax purposes. Petaluma FX Partners, LLC. v. Comm'r of Internal Revenue Serv., 591 F.3d 649 (D.C.Cir.2010). In Petaluma, the purported partnership, Petaluma, was formed with the purpose of engaging in foreign currency option trading. Id. at 650. The partners each contributed pairs of offsetting long and short foreign currency options to become partners in Petaluma. Id. The partners increased their adjusted bases in Petaluma to reflect the long options they contributed, but they did not reduce those bases to reflect Petaluma's assumption of their short options. Id. The partners subsequently withdrew from Petaluma, which fully liquidated their interest in the partnership by distributing cash and shares of Scient stock. Id. Prior to the end of the year, the partners sold their stock, taking their adjusted bases in the distributed stock equivalent to their adjusted bases in Petaluma immediately prior to the distribution. Id. Given the inflated adjusted bases in the stock, these sales created substantial short-term capital losses that the partners claimed on their federal tax returns. Id.

The parties' arguments on appeal in Petaluma were strikingly similar to those in this case. As in the present case, Petaluma argued that outside basis is an affected item, not a partnership item and, therefore, the Tax Court had no right to determine that its partners' outside bases were zero. Id. at 654. Also similar to this case, the government conceded that

outside basis is not a partnership item but then argued that outside basis is an affected item whose elements are largely or entirely partnership items. Id.

The D.C. Circuit agreed with Petaluma, stating that "the partners' outside bases are affected items, not partnership items. Unlike partnership items, affected items are determined not at the partnership level, but at the individual partner level." Id. The court observed that not only are partnership items and affected items treated at different levels, the assessment procedures are different. Id. at 655. In the case of a partnership item, the IRS may directly assess the tax against the individual partner by making a computational adjustment-applying the new tax treatment of all partnership items to the partner's return-and the partner must bring a refund claim to challenge the computation. 26 U.S.C. §6230(c)(1). However, if the partner's liability relates to affected items, the IRS must send a notice of deficiency to that partner, thereby initiating a deficiency proceeding against him individually. 26 U.S.C. §6230(a)(2)(A)(i); see Desmet v. Comm'r of Internal Rev., 581 F.3d 297, 302 (6th Cir.2009) (explaining that the IRS has different procedures for making adjustments to a partner's tax liability depending on whether the item is a partnership item or an affected item).

The court concluded that under §6226(f) the Tax Court did not have jurisdiction to review the determination that the individual partners had no outside basis in Petaluma. The court rejected the government's contention that, although an affected item, outside basis could be determined in the

partnership-level proceeding. "The fact that a determination seems obvious or easy does not expand the court's jurisdiction beyond what the statute provides. In other words, it does not matter how low the fruit hangs when one is forbidden to pick it." Id. at 655.

We find the D.C. Circuit's reasoning persuasive and see no reason to depart from it in this case. While the parties here are different, each of the Ervins' outside basis in Jade is an affected item and thus not determined at the partnership level. See Schell v. United States, 598 F.3d 1378, 1381-82 (Fed.Cir.2009) ("An example of an 'affected item' is a partner's tax basis in his partnership interest, which is affected by partnership items such as partnership income or loss."). We also agree with the D.C. Circuit's observation:

> [N]othing about the concept of outside basis indicates that it is more appropriately determined at the partnership level. If disregarding a partnership leads ineluctably to the conclusion that its partners have no outside basis, that should be just as obvious in partner-level proceedings as it is in partnership-level proceedings. Moreover, with the invalidity of the partnership conclusively established as a partnership-level determination, there is little danger that outside basis will receive inconsistent treatment at the individual partner level.

Petaluma, 591 F.3d at 655.

Because outside basis is not a "partnership item," we conclude that the Court of Federal Claims lacked jurisdiction to determine that the Ervins had no outside basis in Jade.

As explained above, under §6226(f), the trial court has jurisdiction over "the applicability of any penalty ... which relates to an adjustment to a partnership item." The penalty in this case was imposed on the underpayment of income tax due to the gross valuation misstatement of the partners' outside basis in the partnership. Outside basis is an affected item, not a partnership item; thus, the penalty here relates to an adjustment of an affected item, not a partnership item. Accordingly, the trial court did not have jurisdiction over the applicability of this particular penalty.

Because it is possible that at least some portion of the penalties could have been computed without relying on the partners' outside bases, we conclude that the penalty issue should be vacated and remanded. See id. at 655-56 (remanding for a determination as to whether some of the penalties could have been assessed without partner-level computations). Remand proceedings should determine whether any penalties could have been assessed without relying on the Ervins' outside bases.

D

Finally, Jade argues that the Court of Federal Claims should have considered the Ervin's reasonable cause defenses, asserting that Temp. Treas. Reg. §301.6221-1T(c), (d) is invalid. Because we vacate that portion of the Court of Federal Claims' judgment

affirming the penalties assessed against the Ervins, the validity challenge to the temporary regulation is moot at this time, and we decline to reach it. See United States v. Alaska S.S. Co., 253 U.S. 113, 116, 40 S.Ct. 448, 64 L.Ed. 808 (1920) ("[I]t is a settled principle in this court that it will determine only actual matters in controversy essential to the decision of the particular case before it."); see also United States v. UPS Customhouse Brokerage, Inc. 575 F.3d 1376, 1383 (Fed.Cir.2009) (vacating as moot the issue of whether Customs could impose penalties aggregating more than $30,000 under 19 C.F.R. §111.91 when the case was being remanded for Customs to conduct a proper analysis of whether there was in fact a violation of 19 U.S.C. §1641); Elkem Metals Co. v. United States, 468 F.3d 795, 803 (Fed.Cir.2006) (concluding that because an amount was properly excluded from constructed value, the issue of whether the party correctly reported that amount was moot and need not be decided). While the Court of Federal Claims could conclude on remand that some of the penalties could have been assessed without relying on the Ervins' outside basis and thus putting this issue back into play, the opposite is also true. Although these issues are important to the parties and may become relevant later in this case, deciding them now would be premature.

Accordingly, we vacate that portion of the Court of Federal Claims' judgment concluding that the Ervins' partner-level defenses cannot be brought at the partnership level.

III

Because the Court of Federal Claims correctly concluded that the contribution of the spread transactions to Jade lacked economic substance, we affirm the court's denial of Jade's petition for readjustment of partnership items. However, because the Court of Federal Claims lacked jurisdiction to review the penalties imposed on the underpayment of income tax due to the gross valuation misstatement of the Ervins' outside bases in Jade, we vacate that portion of the court's judgment affirming the penalties assessed against the Ervins. Additionally, we remand this issue for the court to determine whether any part of the penalties could have been assessed without relying on the Ervins' outside bases and thus falling within the court's jurisdiction. Finally, we vacate as moot that portion of the Court of Federal Claims' judgment upholding the validity of Temp. Treas. Reg. §301.6221-1T(c), (d).

AFFIRMED-IN-PART, REVERSED-IN-PART, VACATED-IN-PART.

COSTS

Each party shall bear its own costs.

United States Court of Appeals
for the District of Columbia Circuit.

Argued September 24, 2009

Decided January 12, 2010

No. 08-1356

PETALUMA FX PARTNERS, LLC AND
RONALD SCOTT VANDERBEEK, A PARTNER
OTHER THAN THE TAX MATTERS PARTNER,
APPELLANTS

v.

COMMISSIONER OF INTERNAL REVENUE SERVICE,
APPELLEE

Appeal from the United States Tax Court

Edward M. Robbins Jr. argued the cause and filed the briefs for appellants.

Sheldon M. Kay, *Thomas A. Cullinan*, and *Julie P. Bowling* were on the brief for *amicus curiae* AJF-1, LLC in support of appellants.

Joan I. Oppenheimer, Attorney, U.S. Department of Justice, argued the cause for appellee. With her on the brief were *Gilbert S. Rothenberg*, Acting Deputy Assistant Attorney General, and *Richard Farber*, Supervisory Attorney. *Judith A. Hagley*, Attorney, entered an appearance.

Before: SENTELLE, *Chief Judge*, and GRIFFITH and KAVANAUGH, *Circuit Judges*.

Opinion for the Court filed by *Chief Judge* SENTELLE.

SENTELLE, Chief Judge: Petaluma FX Partners, LLC appeals from the Tax Court's decision that it had jurisdiction over several partnership-level determinations and that valuation misstatement penalties applied. Specifically, the Tax Court held that it had jurisdiction to determine that Petaluma was a sham, lacked economic substance, and should be disregarded for tax purposes; that Petaluma's partners had no outside basis in the disregarded partnership; and that the gross valuation misstatement penalty applied. *Petaluma FX Partners, LLC v. Comm'r*, 131 T.C. 9, 2008 WL 4682543 (U.S.Tax Ct. Oct.23, 2008). For the reasons explained below, we affirm the Tax Court's holding that it had jurisdiction to determine that Petaluma was a sham and should be disregarded for tax purposes, but reverse its holding that it had jurisdiction to determine that Petaluma's partners had no outside basis in the partnership. In addition, we set aside the Tax Court's holding that it had jurisdiction to determine whether accuracy-related penalties applied and that the valuation misstatement penalties did apply in this case.

I. Background

A. Factual Background

This case involves a "Son of BOSS" tax shelter. Like many of its kin, this tax shelter employs a series of transactions to create artificial financial losses that are

used to offset real financial gains, thereby reducing tax liability. In 2000, the Internal Revenue Service ("IRS") identified Son of BOSS tax shelters as abusive transactions. I.R.S. Notice 2000-44, 2000-2 C.B. 255; *see also Desmet v. Comm'r*, 581 F.3d 297, 299 (6th Cir.2009). The facts of this case illustrate how this shelter works. We rely primarily on the Tax Court's description of the facts, which is undisputed. *Petaluma*, 2008 WL 4682543, at * 1-3. Petaluma, a purported partnership, was formed on August 18, 2000. Its ostensible purpose was to engage in foreign currency option trading. On October 10, 2000, Ronald Thomas Vanderbeek and Ronald Scott Vanderbeek (collectively, "the Vanderbeeks") each contributed pairs of offsetting long and short foreign currency options to become partners of Petaluma. The Vanderbeeks increased their adjusted bases in Petaluma to reflect the long options they contributed, but did not reduce those bases to reflect Petaluma's assumption of their short options. On December 12, 2000, the Vanderbeeks withdrew from Petaluma, which fully liquidated their interests in the partnership by distributing cash and shares of Scient stock[1] to them. In keeping with 26 U.S.C. §732(b), they took adjusted bases in the distributed stock equivalent to their adjusted bases in Petaluma immediately prior to the distribution. On December 26, 2000, the Vanderbeeks sold their Scient stock. Given their inflated adjusted bases in the stock, these sales created substantial short-term capital losses that the Vanderbeeks subsequently claimed on their 2000 federal income tax returns. For example,

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[1] The stock is not further identified in the parties' submissions.

Ronald Thomas Vanderbeek sold his Scient stock for $122,528 and claimed a short-term capital loss of $17,776,360, which conveniently offset $14,472,420 in longterm capital gains. Likewise, Ronald Scott Vanderbeek sold his Scient stock for $39,410 and claimed a resulting short-term capital loss of $7,631,542, thereby offsetting long-term capital gains of $6,191,778.

B. Statutory Background

Although partnerships do not pay federal income taxes, they must file annual informational returns reporting income, loss, deductions, and credits. 26 U.S.C. §§701, 6031(a); Treas. Reg. §301.6231(a)(3)-1(a)(1)(i). The partners are then responsible for reporting their distributive shares of the partnership's income or loss on their individual federal income tax returns. 26 U.S.C. §§701-702, 704. Congress established the current framework for adjudicating partnership-related tax matters in the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Pub.L. No. 97-248, §402, 96 Stat. 324, 648-67 (codified as amended at 26 U.S.C. §§6221-6232). Prior to TEFRA, all partnership items were determined at the individual taxpayer level, which often required duplicative proceedings for different partners and sometimes resulted in inconsistent treatment of partnership items from partner to partner. Under TEFRA, partnership items are now determined in unified partnership-level audit and judicial proceedings. 26 U.S.C. §6221. When the IRS disagrees with how a partnership return reports partnership items, it may commence an administrative

proceeding by issuing a notice of final partnership administrative adjustment ("FPAA") to the partners. §6223(a), (d). Once an FPAA is mailed, the partnership's tax matters partner has 90 days to file a petition for readjustment of partnership items. §6226(a). If the tax matters partner does not file within that period, any other partner who received the FPAA has an additional 60 days to file a petition. §6226(b)(1). Once a petition has been filed, the reviewing court has jurisdiction to determine all partnership items for the partnership taxable year addressed by the FPAA. §6226(f).

C. The FPAA and the Tax Court's Decision

On April 2, 2001, Petaluma filed a Form 1065 partnership return for its 2000 taxable year. The Commissioner issued an FPAA to the Petaluma partners on July 28, 2005. The FPAA disallowed all partnership items reported on Petaluma's return, reducing them from the amount Petaluma originally claimed to zero. The FPAA also listed "Outside Partnership Basis," which was not originally reported on Petaluma's partnership return, and reduced its value from $24,943,505 to $0. In addition, it included a section titled "EXHIBIT A-Explanation of Items," which determined that Petaluma's existence as a partnership had not been established, that it was formed solely for tax avoidance, that it was a sham and lacked economic substance, and that it should therefore be disregarded for tax purposes. The Explanation also determined that Petaluma's partners "have not established adjusted bases in their respective partnership interests in an amount greater than zero."

Finally, the Explanation determined that various accuracy-related penalties set forth in 26 U.S.C. §6662(a) applied to all underpayments of tax attributable to these adjustments. On December 30, 2005, Ronald Scott Vanderbeek, a Petaluma partner who was not the tax matters partner, filed a petition for readjustment with the Tax Court.

In the Tax Court, Petaluma and the Commissioner entered a settlement of stipulated issues in which Petaluma conceded that the reduction of the line items in its partnership return to zero was appropriate. Petaluma retained just two arguments-first, that the Tax Court lacked jurisdiction to consider certain issues in the FPAA, and second, that the valuation misstatement penalties did not apply. Both parties moved for summary judgment, and the Tax Court granted summary judgment for the Commissioner on October 23, 2008.

In its opinion, the Tax Court first held that it had jurisdiction to determine whether Petaluma should be disregarded for tax purposes. It reasoned that "the determination whether Petaluma is a sham, lacks economic substance, or otherwise should be disregarded for tax purposes is a partnership item over which we have jurisdiction." *Petaluma,* 2008 WL 4682543, at *9. Second, it held that because Petaluma had been disregarded for tax purposes, the court had jurisdiction to determine that the partners' outside bases in the partnership were zero because "there can be no adjusted basis in a disregarded partnership." *Id.* at *10. Third, the court held that it had jurisdiction over the accuracy-related penalties because §6226(f)

gave it jurisdiction to determine "the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item." *Id.* at *11-12 (quoting 26 U.S.C. §6226(f)). Fourth, the court held that "the gross valuation [misstatement] penalty applies when the adjusted basis of property is reduced to zero because a transaction was disregarded as a sham or lacking economic substance and the taxpayer claims an adjusted basis in the property of a greater amount." *Id.* at * 14. Petaluma timely appealed.

II. Analysis

A. Jurisdiction and Standard of Review

Petaluma filed a petition for readjustment of partnership items with the Tax Court under 26 U.S.C. §6226. The Tax Court's decisions concerning such petitions are generally reviewed by the U.S. Court of Appeals for the circuit in which the partnership's principal place of business is located. §7482(b)(1)(E). When a partnership has no principal place of business, as is the case here, the Tax Court's decision "may be reviewed by the Court of Appeals for the District of Columbia." §7482(b)(1). We review the Tax Court's decisions "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." §7482(a)(1). Since the facts of this case are undisputed, we review the questions of law it presents de novo. *Andantech L.L.C. v. Comm'r*, 331 F.3d 972, 976 (D.C.Cir.2003).

B. Disregarding the Partnership

Petaluma contends that the Tax Court erred in holding that it had jurisdiction to determine that the partnership was a sham, lacked economic substance, and should be disregarded for tax purposes. Under TEFRA, a court considering a petition for readjustment has "jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item." 26 U.S.C. §6226(f). Petaluma argues that the Tax Court had no jurisdiction to determine that it was a sham and lacked economic purpose because that determination was not a "partnership item" within the meaning of §6226(f). We disagree.

(1) Section 6233

The jurisdiction of the Tax Court over this case is governed by 26 U.S.C. §6233. That section addresses instances in which a partnership return is filed, but the purported partnership either does not exist or is not actually a partnership. In those situations, §6233 mandates that TEFRA's provisions still apply "to the extent provided in regulations." *Id.* The relevant regulations state that "[a]ny final partnership administrative adjustment or judicial determination ... may include a determination that the entity is not a partnership for such taxable year." Temp. Treas. Reg. §301.6233-1T(a). Under the statutory authority of §6233, this regulation explicitly authorized the Tax

Court to determine that Petaluma was not a partnership for the 2000 taxable year.

(2) Partnership Items

The next question raised by Petaluma's argument is whether the sham determination was a partnership item. The Internal Revenue Code states that "partnership item" means "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level." 26 U.S.C. §6231(a)(3). Thus a partnership item must be (1) "required to be taken into account ... under any provision of subtitle A" and (2) identified by regulation as "more appropriately determined at the partnership level." *Id.* We conclude that the determination that Petaluma was not a valid partnership meets both elements of this test.

(a) Required to Be Taken into Account Under Subtitle A

For the validity of a partnership to be a partnership item, it must be "required to be taken into account ... under any provision of subtitle A," which is the subtitle concerning income taxes. We have little difficulty concluding that application of the income tax provisions of Subtitle A to the tax liability of a taxpayer who receives income from a purported partnership entails a determination of the validity of that partnership. As the Eighth Circuit has stated, "When filling out individual tax returns, the very

process of calculating an outside basis, reporting a sales price, and claiming a capital loss following a partnership liquidation presupposes that the partnership was valid." *RJT Investments X v. Comm'r*, 491 F.3d 732, 736 (8th Cir.2007). Thus the first requirement of the test is met.

(b) More Appropriately Determined at the Partnership Level

In arguing that the second requirement is not met, Petaluma urges that the term "item" should be interpreted narrowly, arguing that it only includes accounting elements such as income, deductions, credit, gain, loss, and basis. As Petaluma concedes, however, the Code does not define "item." Moreover, Petaluma's attempt to cabin the meaning of "partnership item" ignores the statute's plain language authorizing the Secretary to promulgate regulations that flesh out the definition of that term. §6231(a)(3). The regulations that fulfill that mandate give examples of partnership items that include "[t]he partnership's method of accounting, taxable year, and inventory method." Treas. Reg. §301.6231(a)(3)-1(b). These examples make clear that the meaning of "partnership item" extends well beyond technical accounting elements.

Furthermore, the regulations state that the definition of partnership item includes "the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." Treas. Reg. §301.6231(a)(3)-1(b). The determination that a valid partnership exists is a *sine qua non* for determining

the amount and characterization of all other partnership items. For example, determining whether there is a valid partnership necessarily controls whether there can be partnership income, partnership gain, partnership losses, and so forth. This regulation establishes that the validity of a partnership is "more appropriately determined at the partnership level," thereby meeting the second requirement of the partnership item test. Thus the determination that a partnership is a sham and lacks economic substance is a partnership item because it is a legal determination that underlies the amount and characterization of other partnership items. *RJT Investments X*, 491 F.3d at 737-38; *Keener v. United States*, 551 F.3d 1358, 1366 (Fed.Cir.2009) (stating that "the nature of a partnership's transaction-and, specifically, whether a partnership transaction is a 'sham'-is a partnership item").

Logically, it makes perfect sense to determine whether a partnership is a sham at the partnership level. A partnership cannot be a sham with respect to one partner, but valid with respect to another. In addition, this conclusion is unsurprising given that this court has affirmed the Tax Court's determinations that a partnership should be disregarded for tax purposes on several prior occasions. *Andantech L.L.C. v. Comm'r*, 331 F.3d 972, 980 (D.C.Cir.2003); *ASA Investerings P'ship v. Comm'r*, 201 F.3d 505, 506 (D.C.Cir.2000). Based on §6233, its implementing regulations, and the regulations elucidating the meaning of "partnership item," we hold that the determination that Petaluma was a sham, lacked economic substance, and should be disregarded for tax

purposes is a partnership item. Given the Tax Court's jurisdiction under §6226(f) to determine all partnership items, we conclude that the Tax Court acted within its jurisdiction when it determined that Petaluma was not a valid partnership and should be disregarded for tax purposes.

C. Outside Basis

Petaluma also argues that the Tax Court erred in holding that it had jurisdiction to determine that Petaluma's partners had no outside basis in the disregarded partnership. An "outside basis" is the value assigned to a partner's investment in his or her partnership interest. *See American Boat Co. v. United States,* 583 F.3d 471, 474 n. 1 (7th Cir.2009). Under §6226(f), a court reviewing a petition for readjustment of partnership items only has jurisdiction to determine "partnership items." Under TEFRA, every item that is not a partnership item is considered a "nonpartnership item." §6231(a)(4). Items that are affected by one or more partnership items are "affected items." §6231(a)(5). Petaluma argues that outside basis is an affected item, not a partnership item, and therefore the Tax Court had no right to determine that its partners' outside bases were zero. We agree.

On appeal the Commissioner concedes that outside basis is not a partnership item in this case. Instead, he asserts that outside basis is an affected item whose elements are mainly or entirely partnership items. He maintains that the Tax Court had jurisdiction to state the "obvious conclusion" that a partner cannot have any basis in a disregarded partnership. The correctness of this conclusion is immaterial, however, for the

question is not whether the Tax Court's determination was correct, but whether the Tax Court had jurisdiction to make that determination at all in this partnership-level proceeding.

Here, the partners' outside bases are affected items, not partnership items. Unlike partnership items, affected items are determined not at the partnership level, but at the individual partner level. Once the partnership items have been finalized, the IRS may make a corresponding "computational adjustment" to each partner's tax liability. 26 U.S.C. §6230(c)(1)(A)(ii); §6231(a)(6). When a computational adjustment directly increases a partner's tax liability, the IRS can assess the tax and the partner must bring a refund claim to challenge the computation. §6230(c)(1). When a computational adjustment's effect indirectly increases a partner's tax liability and necessitates partner-level determinations concerning affected items, however, the IRS must issue a notice of deficiency, and normal deficiency procedures apply. §6230(a)(2)(A)(i); *Desmet v. Comm'r*, 581 F.3d 297, 302 (6th Cir.2009) (describing these two assessment procedures).

Under §6226(f), the Tax Court had jurisdiction to determine partnership items, but it did not have jurisdiction to determine affected items. We have already rejected the Tax Court's conclusion that outside basis was a partnership item in this case, and we likewise reject the Commissioner's contention that outside basis, although it is an affected item, could nonetheless be determined in the partnership-level proceeding. The fact that a determination seems obvious or easy does not expand the court's jurisdiction

beyond what the statute provides. In other words, it does not matter how low the fruit hangs when one is forbidden to pick it. We hold that the Tax Court had no jurisdiction to determine that Petaluma's partners had no outside basis in the disregarded partnership. Finally, we note that nothing about the concept of outside basis indicates that it is more appropriately determined at the partnership level. If disregarding a partnership leads ineluctably to the conclusion that its partners have no outside basis, that should be just as obvious in partner-level proceedings as it is in partnership-level proceedings. Moreover, with the invalidity of the partnership conclusively established as a partnership-level determination, there is little danger that outside basis will receive inconsistent treatment at the individual partner level.

D. Penalties

Petaluma also challenges the Tax Court's jurisdiction over accuracy-related penalties. The FPAA determined that "the accuracy-related penalty under Section 6662(a) of the Internal Revenue Code applies to all underpayments of tax attributable to adjustments of partnership items of Petaluma FX Partners, LLC." Petaluma argues that since the Tax Court lacked jurisdiction to determine outside basis, it also lacks jurisdiction to determine that penalties apply with respect to outside basis because those penalties do not relate to an adjustment to a partnership item. We agree. As the Tax Court noted, penalties were formerly determined at the partner level. *Petaluma,* 2008 WL 4682543, at *11; *American Boat Co. v. United States,* 583 F.3d 471, 478 (7th

Cir.2009). In the Taxpayer Relief Act of 1997, Pub.L. No. 105-34, §1238, 111 Stat. 788, 1026, Congress amended §6221 and §6226(f) so that penalties relating to adjustments to partnership items would be determined at the partnership level. *American Boat Co.*, 583 F.3d at 478. Section 6221 now states that "the tax treatment of any partnership item (*and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item*) shall be determined at the partnership level" (emphasis added). Likewise, §6226(f) now provides that a court reviewing a petition for readjustment has "jurisdiction to determine ... *the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item* " (emphasis added).

The Tax Court held that its determination that Petaluma should be disregarded for tax purposes sufficed to give it jurisdiction over accuracy-related penalties. *Petaluma,* 2008 WL 4682543, at * 12. We disagree. True, the determination that Petaluma should be disregarded for tax purposes is a partnership item, but the outside bases of the partners are affected items to be resolved at the partner level. Neither the Tax Court nor the Commissioner on appeal have forwarded any basis for the jurisdiction of the Tax Court over affected items in this proceeding. As it is not clear from the opinion, the record, or the arguments before this court that the penalties asserted by the Commissioner and ordered by the Tax Court could have been computed without partner-level proceedings to determine the affected-items questions concerning outside bases, we are unable to uphold the

court's determination of the penalty issues. While it may be that some penalties could have been assessed without partner-level computations, we cannot affirm a decision that has not yet been made. Therefore, we vacate the opinion of the Tax Court on the penalties imposition and computation. It may be that upon remand, a determination can be made for some portion of the penalties, but neither party has briefed that question before us.

III. Conclusion

For the reasons set forth above, the decision of the Tax Court is affirmed in part and reversed in part. We affirm the decision of the court that it had jurisdiction to determine the sham nature of the partnership entity. We reverse the decision of the Tax Court insofar as it asserted jurisdiction over the outside-basis issues. We vacate and remand for further proceedings the Tax Court's decision on the penalties question.

So ordered.

App: 127 - App:150
Intentionally omitted.

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

2008-5129

EDWARD J. DEEGAN and JOAN S. DEEGAN

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in 06-CV-594, Judge Lawrence J. Block.

ORDER

NOTE: This order is nonprecedential.

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

ORDER

A petition for rehearing en banc having been filed by the Appellants, and the matter having first been referred as a petition for rehearing to the panel that heard the appeal, and thereafter the petition for rehearing en banc having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED.

The mandate of the court will issue on August 10, 2010.

FOR THE COURT,

/s/ Jan Horbaly, lb

Jan Horbaly
Clerk

Dated: 08/30/2010

Stamped
Filed

cc: Sallie W. Gladney
Deborah K. Snyder
DEEGAN V US, 2008-5129
(CFC-04-CV-060)

U.S. Court of Appeals for
the Federal Circuit
Aug 03 2010
Jan Horbaly, Clerk

CONSTITUTION OF THE UNITED STATES OF AMERICA

ARTICLE I, SECTION 8, CLAUSE 1

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States; . . . .

. . . .

ARTICLE I, SECTION 8, CLAUSE 9

The Congress shall have Power . . . To constitute Tribunals inferior to the supreme Court; . . . .

. . . .

ARTICLE III, SECTION 1

The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services a Compensation, which shall not be diminished during their Continuance in Office.

. . . .

ARTICLE III, SECTION 2

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made under their Authority;—to all Cases affecting Ambassadors, other public Ministers and Consuls;—to all Cases of admiralty and maritime jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;—between Citizens of different States,—between Citizens of the same State claiming Lands under the Grants of different States.

INTERNAL REVENUE CODE (26 U.S.C.)

Effective for Tax Year 1985

SEC. 6221. TAX TREATMENT DETERMINED AT PARTNERSHIP LEVEL

Except as otherwise provided in this subchapter, the tax treatment of any partnership item shall be determined at the partnership level.

SEC. 6222. PARTNER'S RETURN MUST BE CONSISTENT WITH PARTNERSHIP RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY

(a) IN GENERAL.—A partner shall, on the partner's return, treat a partnership item in a manner which is consistent with the treatment of such partnership item on the partnership return.

* * * *

SEC. 6223. NOTICE TO PARTNERS OF PROCEEDINGS.

(a) SECRETARY MUST GIVE PARTNERS NOTICE OF BEGINNING AND COMPLETION OF ADMINISTRATIVE PROCEEDINGS.—The Secretary shall mail to each partner whose name and address is furnished to the Secretary notice of—

* * * *

(2) the final partnership administrative adjustment resulting from any such proceeding.

* * * *

(d) PERIOD FOR MAILING NOTICE.— . . .

(2) NOTICE OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENT.—The Secretary shall mail the notice specified in paragraph (2) of subsection (a) to each partner entitled to such notice not later than the 60th day after the day on which the notice specified in such paragraph (2) was mailed to the tax matters partner.

* * * *

(f) ONLY ONE NOTICE OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENT.—If the Secretary mails a notice of final partnership administrative adjustment for a partnership taxable year with respect to a partner, the Secretary may not mail another such notice to such partner with respect to the same taxable year of the same partnership in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact.

SEC. 6224. PARTICIPATION IN ADMINISTRATIVE PROCEEDINGS; WAIVERS; AGREEMENTS.

* * * *

(c) SETTLEMENT AGREEMENT.—In the absence of a showing of fraud, malfeasance, or misrepresentation of fact—

(1) BINDS ALL PARTIES.—A settlement agreement between the Secretary and 1 or more partners in a partnership with respect to the determination of partnership items for any partnership taxable year shall (except as otherwise provided in such agreement) be binding on all parties to such agreement with respect to the determination of partnership items for such partnership taxable year. . . .

(2) OTHER PARTNERS HAVE RIGHT TO ENTER INTO CONSISTENT AGREEMENTS.—If the Secretary enters into a settlement agreement with any partner with respect to partnership items for any partnership taxable year, the Secretary shall offer to any other partner who so requests settlement terms for the partnership taxable year which are consistent with those contained in such settlement agreement. . . .

(3) TAX MATTERS PARTNER MAY BIND CERTAIN OTHER PARTNERS.—

(A) IN GENERAL.—A partner who is not a notice partner (and not a member of a notice group described in subsection (b)(2) of section

6223) shall be bound by any settlement agreement—

(i) which is entered into by the tax matters partner, and

(ii) in which the tax matters partner expressly states that such agreement shall bind the other partners.

* * * *

SEC. 6225. ASSESSMENTS MADE ONLY AFTER PARTNERSHIP LEVEL PROCEEDINGS ARE COMPLETED.

(a) RESTRICTION ON ASSESSMENT AND COLLECTION.—Except as otherwise provided in this subchapter, no assessment of a deficiency attributable to any partnership item may be made (and no levy or proceeding in any court for the collection of any such deficiency may be made, begun, or prosecuted) before—

(1) the close of the 150th day after the day on which a notice of a final partnership administrative adjustment was mailed to the tax matters partner, and

(2) if a proceeding is begun in the Tax Court under section 6226 during such 150-day period, the decision of the court in such proceeding has become final.

* * * *

SEC. 6226. JUDICIAL REVIEW OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENTS

(a) PETITION BY TAX MATTERS PARTNER.—Within 90 days after the day on which a notice of a final partnership administrative adjustment is mailed to the tax matters partner, the tax matters partner may file a petition for a readjustment of the partnership items for such taxable year with—

(1) the Tax Court,

(2) the district court of the United States for the district in which the partnership's principal place of business is located, or

(3) the Claims Court.

(b) PETITION BY PARTNER OTHER THAN TAX MATTERS PARTNER.—

(1) IN GENERAL.—If the tax matters partner does not file a readjustment petition under subsection (a) with respect to any final partnership administrative adjustment, any notice partner (and any 5-percent group) may, within 60 days after the close of the 90-day period set forth in subsection (a), file a petition for a readjustment of the partnership items for the taxable year involved with any of the courts described in subsection (a).

* * * *

(5) TAX MATTERS PARTNER MAY INTERVENE.—The tax matters partner may intervene in any action brought under this section.

* * * *

(c) PARTNERS TREATED AS PARTIES.—If an action is brought under subsection (a) or (b) with respect to a partnership for any partnership taxable year—

(1) each person who was a partner in such partnership at any time during such year shall be treated as a party to such action, and

(2) the court having jurisdiction of such action shall allow each such person to participate in the action.

(d) PARTNER MUST HAVE INTEREST IN OUTCOME.—

(1) IN ORDER TO BE PARTY TO ACTION.—Subsection (c) shall not apply to a partner after the day on which—

(A) the partnership items of such partner for the partnership taxable year became nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, or

(B) the period within which any tax attributable to such partnership items may be assessed against that partner expired.

(2) TO FILE PETITION.—No partner may file a readjustment petition under subsection (b) unless such partner would (after the application of paragraph (1) of this subsection) be treated as a party to the proceeding.

* * * *

(f) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates and the proper allocation of such items among the partners.

(g) DETERMINATION OF COURT REVIEWABLE.—Any determination by a court under this section shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the

Claims Court, as the case may be, and shall be reviewable as such. With respect to the partnership, only the tax matters partner, a notice partner, or a 5-percent group may seek review of a determination by a court under this section.

(h) EFFECT OF DECISION DISMISSING ACTION.—If an action brought under this section is dismissed (other than under paragraph (4) of subsection (b)), the decision of the court dismissing the action shall be considered as its decision that the notice of final partnership administrative adjustment is correct, and an appropriate order shall be entered in the records of the court.

SEC. 6228. JUDICIAL REVIEW WHERE ADMINISTRATIVE ADJUSTMENT REQUEST IS NOT ALLOWED IN FULL.

(a) REQUEST ON BEHALF OF PARTNERSHIP.—

* * * *

(4) PARTNERS TREATED AS PARTY TO ACTION.—

* * * *

(B) PARTNERS MUST HAVE INTEREST IN OUTCOME.—For purposes of subparagraph (A), rules similar to the rules of paragraph (1) of section 6226(d) shall apply.

* * * *

SEC. 6229. PERIOD OF LIMITATIONS FOR MAKING ASSESSMENTS

(a) GENERAL RULE.—Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of—

(1) the date on which the partnership return for such taxable year was filed, or

(2) the last day for filing such return for such year (determined without regard to extensions).

(b) EXTENSION BY AGREEMENT.—

(1) IN GENERAL.—The period described in subsection (a) (including an extension period under this subsection) may be extended—

(A) with respect to any partner, by an agreement entered into by the Secretary and such partner, and

(B) with respect to all partners, by an agreement entered into by the Secretary and the tax matters partner (or any other person authorized by the partnership in writing to enter into such an agreement),

before the expiration of such period.

(2) COORDINATION WITH SECTION 6501(c)(4).—Any agreement under section 6501(c)(4) shall apply with respect to the period described in subsection (a) only if the agreement

expressly provides that such agreement applies to tax attributable to partnership items.

* * * *

(d) SUSPENSION WHEN SECRETARY MAKES ADMINISTRATIVE ADJUSTMENT.—If notice of a final partnership administrative adjustment with respect to any taxable year is mailed to the tax matters partner, the running of the period specified in subsection (a) (as modified by other provisions of this section) shall be suspended—

(1) for the period during which an action may be brought under section 6226 (and, if an action an action with respect to such administrative adjustment is brought during such period, until the decision of the court in such action becomes final), and

(2) for 1 year thereafter.

* * * *

(f) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If, before the expiration of the period otherwise provided in this section for assessing any tax imposed by subtitle A with respect to the partnership items of a partner for the partnership taxable year, such items become nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, the period for assessing any tax imposed by subtitle A which is attributable to such items (or any item affected by such items) shall not expire before the date which is 1 year after the date on which the items become nonpartnership items. The period described in

the preceding sentence (including any extension period under this sentence) may be extended with respect to any partner by agreement entered into by the Secretary and such partner.

* * * *

SEC. 6230. ADDITIONAL ADMINISTRATIVE PROVISIONS

(a) COORDINATION WITH DEFICIENCY PROCEEDINGS.—

(1) IN GENERAL.—Except as provided in paragraph (2), subchapter B of this chapter shall not apply to the assessment or collection of any computational adjustment.

(2) DEFICIENCY PROCEEDINGS TO APPLY IN CERTAIN CASES.—

(A) Subchapter B shall apply to any deficiency attributable to—

(i) affected items which require partner level determinations, or

(ii) items which have become nonpartnership items (other than by reason of section 6231(b)(1)(C)) and are described in section 6231(e)(1)(B).

* * * *

(c) CLAIMS ARISING OUT OF ERRONEOUS COMPUTATIONS, ETC.—

(1) IN GENERAL.—A partner may file a claim for refund on the grounds that—

* * * *

(B) the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement, a final

partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a).

* * * *

(4) NO REVIEW OF SUBSTANTIVE ISSUES.—For purposes of any claim or suit under this subsection, the treatment of partnership items on the partnership return, under the settlement, under the final partnership administrative adjustment, or under the decision of the court (whichever is appropriate) shall be conclusive.

* * * *

(l) COURT RULES.—Any action brought under any provision of this subchapter shall be conducted in accordance with such rules of practice and procedure as may be prescribed by the Court in which the action is brought.

SEC. 6231. DEFINITIONS AND SPECIAL RULES

(a) DEFINITIONS.—For purposes of this subchapter

* * * *

(3) PARTNERSHIP ITEM.—The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

(4) NONPARTNERSHIP ITEM.—The term "nonpartnership item" means an item which is (or is treated as) not a partnership item.

(5) AFFECTED ITEM.—The term "affected item" means any item to the extent such item is affected by a partnership item.

(6) COMPUTATIONAL ADJUSTMENT.—The term "computational adjustment" means the change in the tax liability of a partner which properly reflects the treatment under this subchapter of a partnership item. . . . .

(7) TAX MATTERS PARTNER.—The tax matters partner of any partnership is—

(A) the general partner designated as the tax matters partner as provided in regulations, or

(B) if there is no general partner who has been so designated, the general partner having the largest profits interest in the partnership at the close of the taxable year involved (or, where there is more than 1 such partner, the 1 of such partners whose name would appear first in an alphabetical listing).

If there is no general partner designated under subparagraph (A) and the Secretary determines that it is impracticable to apply subparagraph (B), the partner selected by the Secretary shall be treated as the tax matters partner.

* * * *

(b) ITEMS CEASE TO BE PARTNERSHIP ITEMS IN CERTAIN CASES.—

(1) IN GENERAL.—For purposes of this subchapter, the partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date—

* * * *

(C) the Secretary enters into a settlement agreement with the partner with respect to such items, or

* * * *

(c) REGULATIONS WITH RESPECT TO CERTAIN SPECIAL ENFORCEMENT AREAS.—

(1) APPLICABILITY OF SUBSECTION.—This subsection applies in the case of—

* * * *

(E) other areas that the Secretary determines by regulation to present special enforcement considerations.

(2) ITEMS MAY BE TREATED AS NONPARTNERSHIP ITEMS.—To the extent that the Secretary determines and provides by regulations that to treat items as partnership items will interfere with the effective and efficient enforcement of this title in any case described in paragraph (1), such items shall be treated as non-partnership items for purposes of this subchapter.

* * * *

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION

(a) GENERAL RULE.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * *

SEC. 6621. DETERMINATION OF RATE OF INTEREST

* * * *

(c) INTEREST ON SUBSTANTIAL UNDERPAYMENTS ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—

(1) IN GENERAL.—In the case of interest payable under section 6601 with respect to any substantial underpayment attributable to tax motivated transactions, the rate of interest established under this section shall be 120 percent of the underpayment rate established under this subsection.

(2) SUBSTANTIAL UNDERPAYMENT ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—For purposes of this subsection, the term "substantial underpayment attributable to tax motivated transactions" means any underpayment of taxes imposed by subtitle A for any taxable year which is attributable to 1 or more tax motivated transactions if the amount of the underpayment for such year so attributable exceeds $1,000.

(3) TAX MOTIVATED TRANSACTIONS.—

(A) In general.—For purposes of this subsection, the term "tax motivated transaction" means—

(i) any valuation overstatement (within the meaning of section 6659(c)),

(ii) any loss disallowed by reason of section 465(a) and any credit disallowed under section 46(a)(8),

(iii) any straddle (as defined in section 1092(c) without regard to subsections (d) and (e) of section 1092),

(iv) any use of an accounting method specified in regulations prescribed by the Secretary as a use which may result in a substantial distortion of income for any period, and

(v) any sham or fraudulent transaction.

* * * *

SEC. 7422. CIVIL ACTIONS FOR REFUND

(a) No suit prior to filing claim for refund.--No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

* * * *

(h) Special rule for actions with respect to partnership items.—No action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c).

SEC. 7441. STATUS

There is hereby established, under article I of the Constitution of the United States, a court of record to be known as the United States Tax Court. The members of the Tax Court shall be the chief judge and the judges of the Tax Court.

SEC. 7442. JURISDICTION

The Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title, by chapters 1, 2, 3, and 4 of the Internal Revenue Code of 1939, by title II and title III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926.

INTERNAL REVENUE CODE (26 U.S.C.)

As Amended - Effective for
Tax Year Ending After August 5, 1997

§6226. JUDICIAL REVIEW OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENTS

* * * *

(d) PARTNER MUST HAVE INTEREST IN OUTCOME.—

(1) In order to be party to action.—Subsection (c) shall not apply to a partner after the day on which—

(A) the partnership items of such partner for the partnership taxable year became nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, or

(B) the period within which any tax attributable to such partnership items may be assessed against that partner expired.

Notwithstanding subparagraph (B), any person treated under subsection (c) as a party to an action shall be permitted to participate in such action (or file a readjustment petition under subsection (b) or paragraph (2) of this subsection) solely for the purpose of asserting that the period of limitations for assessing any tax attributable to partnership

items has expired with respect to such person, and the court having jurisdiction of such action shall have jurisdiction to consider such assertion.

* * * *

(F) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.

JUDICIARY AND JUDICIAL PROCEDURE (28 U.S.C.)

§171. APPOINTMENT AND NUMBER OF JUDGES; CHARACTER OF COURT; DESIGNATION OF CHIEF JUDGE

(a) The President shall appoint, by and with the advice and consent of the Senate, sixteen judges who shall constitute a court of record known as the United States Court of Federal Claims. The court is declared to be a court established under article I of the Constitution of the United States.

§1346. UNITED STATES AS DEFENDANT

(a) The district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims, of:

(1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws.

* * * *

(e) The district courts shall have original jurisdiction of any civil action against the United States provided in section 6226, 6228(a), 7426, or 7428 (in the case of the United States district court

for the District of Columbia) or section 7429 of the Internal Revenue Code of 1986.

§1491. CLAIMS AGAINST UNITED STATES GENERALLY; ACTIONS INVOLVING TENNESSEE VALLEY AUTHORITY

(a)(1) The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort. For the purpose of this paragraph, an express or implied contract with the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges, or Exchange Councils of the National Aeronautics and Space Administration shall be considered an express or implied contract with the United States.

(2) To provide an entire remedy and to complete the relief afforded by the judgment, the court may, as an incident of and collateral to any such judgment, issue orders directing restoration to office or position, placement in appropriate duty or retirement status, and correction of applicable records, and such orders may be issued to any appropriate official of the United States. In any case within its jurisdiction, the court shall have the power to remand appropriate matters to any

administrative or executive body or official with such direction as it may deem proper and just. The Court of Federal Claims shall have jurisdiction to render judgment upon any claim by or against, or dispute with, a contractor arising under section 10(a)(1) of the Contract Disputes Act of 1978, including a dispute concerning termination of a contract, rights in tangible or intangible property, compliance with cost acccunting standards, and other nonmonetary disputes on which a decision of the contracting officer has been issued under section 6 of that Act.

[(3) Repealed. Pub.L. 104-320, §12(a)(2), Oct. 19, 1996, 110 Stat. 3874]

§1508. JURISDICTION FOR CERTAIN PARTNERSHIP PROCEEDINGS

The Court of Federal Claims shall have jurisdiction to hear and to render judgment upon any petition under section 6226 or 6228(a) of the Internal Revenue Code of 1986.

Federal Regulations
Effective for the Tax Years in Issue

Treas. Reg. §301.6621-2T. Questions and answers relating to the increased rate of interest on substantial underpayments attributable to certain tax motivated transactions (temporary).

The following questions and answers relate to the increased rate of interest on substantial underpayments attributable to certain tax motivated transactions as provided in section 6621(d) of the Internal Revenue Code of 1954, as added by section 144 of the Tax Reform Act of 1984 (Pub.L. 98-369, 98 Stat. 682):

* * * *

Q-5. How is the amount of a tax motivated underpayment determined?

A-5. Except as provided in A-6 of this section, the amount of a tax motivated underpayment is determined in the following manner:

(1) Calculate the amount of the tax liability for the taxable year as if all items of income, gain, loss, deduction, or credit, had been reported properly on the income tax return of the taxpayer ("total tax liability"); and

(2) Without taking into account any adjustments to items of income, gain, loss, deduction, or credit that are attributable to tax motivated transactions (as defined in A-2 through A-4 of this section), calculate the amount of the tax liability for the taxable year as if all other items of income, gain, loss, deduction, or credit

had been reported properly on the income tax return of the taxpayer ("tax liability without regard to tax motivated transactions").

(3) The difference between the total tax liability and the tax liability without regard to tax motivated transactions is the amount of the tax motivated underpayment.

Example. Taxpayer A, a calendar year taxpayer, files his 1984 income tax return reporting $70,000 of taxable income and $23,171 of tax liability. On January 20, 1986, A enters into a closing agreement with the Internal Revenue Service that includes the following adjustments:

Section 162 deduction disallowed (not tax motivated)	$ 7,500
Loss disallowed under section 465 (tax motivated--see A-2(2) of this section)	$ 5,000
Section 170 deduction disallowed because of a valuation overstatement (tax motivated--see A-2(1) of this section	$10,000
Loss disallowed with respect to a straddle as defined in section 1092 (c) (tax motivated--see A-2(4) of this section	$ 7,000
Other adjustments (none of which are tax motivated)	$ 4,000

The tax motivated underpayment is determined in the following manner:

1.	$ 70,000	reported taxable income
	+ 33,500	(Add all adjustments to items of income, gain, loss, deduction, or credit (including tax motivated transactions subject to section 6621(d)))
	$103,500	Tax = $39,685 ("total tax liability")
2.	$ 70,000	reported taxable income
	+ 11,500	(Add adjustments to items of income, gain, loss, deduction, or credit other than those with respect to items that are tax motivated)
	$ 81,500	tax = $28,691 ("tax liability without regard to tax motivated transactions")

The tax motivated underpayment (*i.e.*, the underpayment attributable to tax motivated transactions) is $10,994 ($39,685 $28,691). Accordingly, the interest on $10,994 would be computed at the 120 percent rate.

The remainder of the underpayment (*i.e.*, the underpayment not attributable to tax motivated transactions) is $5,520 ($28,691 (tax liability without regard to tax motivated items) $23,171 (tax paid with return)). The interest on $5,520 would be computed at the adjusted rate.

Tax Court Rules

RULE 245. INTERVENTION AND PARTICIPATION

(a) Tax Matters Partner: The tax matters partner may intervene in an action for readjustment of partnership items brought by another partner or partners by filing a notice of election to intervene with the Court. . . . . See Code sec. 6226(b)(2); Rule 241(d)(3).

(b) Other Partners: Any other partner who satisfies the requirements of Code §6226(d) or 6228(a)(4)(B) may participate in the action by filing a notice of election to participate with the Court. . . .

RULE 247. PARTIES

(a) In General: For purposes of this title of these Rules, the Commissioner, the partner who filed the petition, the tax matters partner, and each person who satisfies the requirements of Code §6226(c) and (d) or 6228(a)(4) shall be treated as parties to the action.

(b) Participating Partners: Participating partners are the partner who filed the petition and such other partners who have filed either a notice of election to intervene or a notice of election to participate in accordance with the provisions of Rule 245. See Code §§6226(c), 6228(a)(4)(A).

RULE 248. SETTLEMENT AGREEMENTS

* * * *

(b) Settlement or Consistent Agreements Entered Into by All Participating Partners or No Objection by Participating Partners:

(1) After the expiration of the time within which to file a notice of election to intervene or to participate under Rule 245(a) or (b), the Commissioner shall move for entry of decision, and shall submit a proposed form of decision with such motion, if—

* * * *

(B) the tax matters partner (if a participating partner) agrees to the proposed decision in the case but does not certify that no party objects to the granting of the Commissioner's motion for entry of decision.

* * * *

(c) Other Settlement and Consistent Agreements: If a settlement agreement or consistent agreement is not within the scope of paragraph (b) of this Rule, then—

(1) in the case of a participating partner, the Commissioner shall promptly file with the Court a notice of settlement agreement or notice of consistent agreement, whichever may be appropriate, that identifies the participating partner or partners who have entered into the settlement agreement or consistent agreement; . . . .

In the United States Court of Federal Claims

No. 06-594 T

EDWARD J. DEEGAN
AND JOAN S. DEEGAN

v. **JUDGMENT**

THE UNITED STATES

Pursuant to the court's Published Opinion and Order, filed April 16, 2008, denying plaintiffs' motion for summary judgment, and granting the motions of the United States,

IT IS ORDERED AND ADJUDGED this date, pursuant to Rule 58, that all claims by the plaintiffs are dismissed for lack of jurisdiction.

John S. Buckley
Acting Clerk of the Court

April 18, 2008 By: s/Lisa L. Reyes

Deputy Clerk

NOTE: As to appeal, 60 days from this date, see RCFC 58.1, re number of copies and listing of all plaintiffs. Filing fee is $455.00.

Table 1
Indirectly Related Appeals
Pending Before the Federal Circuit

Appeal	Docket
Acker,et al. v. U.S.	2008-5161
Adams, et al. v. U.S.	2008-5168
Aylward, et al. v. U.S.	2008-5143
Baer, et al. v. U.S.	2008-5165
Berman, et al. v. U.S.	2008-5164
Brady, et al. v. U.S.	2008-5156
Caldwell, et al. v. U.S.	2008-5154
Clinton, et al. v. U.S.	2008-5150
Connell, et al. v. U.S.	2008-5148
Cox, et al. v. U.S.	2008-5151
Crocker, et al. v. U.S.	2008-5147
Crouse v. U.S.	2008-5146
Davidson, et al. v. U.S.	2008-5152
Davis v. U.S.	2008-5142
Davis, et al. v. U.S.	2008-5145
Davison, et al. v. U.S.	2008-5128
Dhillon, et al. v. U.S.	2008-5172
Dow, et al. v. U.S.	2008-5155
Ehrenbard, et al. v. U.S.	2008-5169
Fazio, et al. v. U.S.	2008-5163
Gilbertson, et al. v. U.S.	2008-5157
Goldman ,et al. v. U.S.	2008-5162
Gregory,et al. v. U.S.	2008-5149

Appeal	Docket
Hackett, et al. v. U.S.	2008-5126
Hastie, et al. v. U.S.	2008-5127
Hatton, et al. v. U.S.	2008-5137
Higuera v. U.S.	2008-5166
Iannacchino, et al. v. U.S.	2008-5170
Johnson, et al. v. U.S.	2008-5167
Johnson, et al. v. U.S.	2008-5171
Jones, et al. v. U.S.	2008-5118
Jones, et al. v. U.S.	2008-5144
Keefe, et al. v. U.S.	2008-5116
Key, et al. v. U.S.	2008-5119
Lloyd v. U.S.	2008-5158
Ludwig, et al. v. U.S.	2008-5160
Lyons, et al. v. U.S.	2008-5159
Marshall, et al. v. U.S.	2008-5121
Miller, et al. v. U.S.	2008-5120
Mitchell, et al. v. U.S.	2008-5122
Montgomery, et al. v. U.S.	2008-5123
Moody, et al. v. U.S.	2008-5124
Morris, et al. v. U.S.	2008-5125
Oehlschlager, et al. v. U.S.	2008-5140
Oldshue, et al. v. U.S.	2008-5132
Sadd, et al. v. U.S.	2008-5141
Sperling, et al. v. U.S.	2008-5130
Tanner, et al. v. U.S.	2008-5131
Ungs, et al. v. U.S.	2008-5133

Appeal	Docket
Vallari, et al. v. U.S.	2008-5134
Vigliotta, et al. v. U.S.	2008-5135
Voda, et al. v. U.S.	2008-5136
Whitaker, et al. v. U.S.	2008-5138